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CIS

INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

INFLUENCING SMALL BUSINESS INVESTMENT IN
ENTERPRISE ZONES

WASHINGTON, D.C.—FEBRUARY 25, 1982
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INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

THURSDAY, FEBRUARY 25, 1982

U.S. Senate,
Committee on Small Business,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 424, Russell Senate Office Building, Hon. Rudy Boschwitz, acting chairman of the committee, presiding.

Present: Senators Boschwitz, Hayakawa, D'Amato, and Tsongas.

Also present: Robert J. Dotchin, staff director; Robert M. Wilson, counsel; Alan L. Chvotkin, chief counsel, minority; and Dorothy C. Olson, hearing clerk.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator Boschwitz. The hearing will come to order. I ask our first panel, Prof. David Birch and Dr. Stuart Butler, to come forward if they would.

I have an opening statement that gives an oversight of the enterprise zone bill, and the various problems that it seeks to address, and hopes to overcome. We certainly do not represent this bill as being the one that is going to take unemployment from the present level of 8.5 percent to 6.5 percent but certainly it will be a contributing factor, particularly in areas of very high unemployment where all the efforts of Government thus far have seemed to be without avail.

Our Nation long ago accepted the responsibility of taking care of those who cannot take care of themselves. We have spent a lot of money doing just that. Unfortunately, we have not been as wise as we have been generous in meeting this responsibility. Today our social welfare obligations cost the Government nearly half the Federal budget. One economist estimates that if we would just give to the poor all the money we spend on programs for them, we would raise all Americans above the poverty level.

Clearly we need a new approach in assisting our poor and jobless. The current antipoverty programs do provide crucial services but do not, on their own, appear to achieve any lasting good. They are for the most part stopgap policies that address the symptoms but not the causes of poverty. They have failed to provide any meaningful opportunity for advancement.

In fact, the present system has trapped many of our poor in a self-perpetuating cycle of poverty. Instead of offering the poor a chance to pull themselves and their families out of poverty, the present programs unwittingly trap recipients in a self-perpetuating quagmire of poverty from which even the most enterprising have trouble emerging.

The answer is not spending more Government money. The answer is jobs—jobs in the private sector. Although that remedy is easily prescribed, the method toward that cure is not. One means is through enterprise zones, a new concept that deals with joblessness by enlisting the help of the private sector.

In simple terms, the supporters of enterprise zones view the problem of joblessness like this: There are no jobs because there are not enough opportunities in the areas that need them most. Enterprise zones would encourage job creation through a Federal/local package of tax breaks and other incentives to businesses which would locate in a designated zone.

Since I first introduced this bill in the Senate nearly 2 years ago, the response has been excellent. Of course, not all who have written in support agree on each and every provision but all have eagerly welcomed a fresh approach to solving the problems of poverty and joblessness in America.

I am happy that the Small Business Committee has taken up these hearings because this legislation is aimed primarily at small businesses. They create the vast majority of new jobs. In the past 10 years, nearly 20 percent of new private sector employment has come from businesses with 20 or fewer employees; 80 percent of new jobs have been created by businesses with less than 100 employees.

I have been a businessman, so my reasons go deeper than just statistics. Small businesses offer an increased opportunity for rapid advancement when compared to larger corporations. People at the lower end of the wage scale are not so easily lost in the shuffle. In a small business, the employer and employee identify more with one another. A person's qualities, problems, family, and ambitions cannot escape the boss's notice. Getting in at the ground floor of a small business is a very effective method of advancement. It can be stimulating and exciting but more importantly it is a sharp contrast from welfare.

We have also considered the problems of the small businessman. Such problems as crime, weak infrastructure, and city taxes remain a barrier to business development in a potential enterprise zone. These serve as a double whammy when you consider that a prospective business already faces the usual problems of tax burdens, start-up capital, and technical expertise.

We have tackled this problem by combining incentives provided not only by the Federal Government but by local bodies as well. That an area shows signs of high unemployment, poverty, or outmigration is not enough to quality it for an enterprise zone designation. The local government must also assemble a package of tax and other incentives at that level that more expressly meet the particular problems of the area. Moreover, the award of an enterprise zone will be granted on a competitive basis to test local commitment. That could include any number of things, including improved infrastructure support, reduction of local taxes, relaxation of local regulations, managerial assistance, or technical help.

Those local contributions are then matched by Federal tax breaks, such as the elimination of capital gains taxes for business investment in the area, significant reductions in income taxes, and a 5 percent refundable tax credit for wages paid to previously unemployed workers. This local/Federal package addresses the problems that all small businesses face as well as the particular problems of a business located in a depressed area.

There are tax incentives for the workers as well. All employees of an eligible business will receive a refundable tax credit of up to $1,500 a year. This provides the present welfare recipient an additional incentive to go to work by boosting the wage of employees above the $3.20 per hour minimum. It also attracts skilled workers into zones who would otherwise not be interested in job opportunities in depressed areas.

As you can see, this is not just another program that throws money at a problem and hopes it goes away. More spending is not the solution. Given the cost-cutting conscience of the Reagan administration, more spending is not even an option.

Enterprise zones are a step in the right direction. I see it as a cost-effective program that cuts to the root of the problems of our Nation's poor by using the strongest economic ally our country has—free enterprise.

I ask my colleague, Senator Hayakawa, if he has a statement he wishes to make at this time.

STATEMENT OF HON. S. I. HAYAKAWA, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator **Hayakawa**. Thank you, Mr. Chairman.

I would like to thank the chairman of the Small Business Committee, Senator Weicker, for announcing this hearing on the subject of small business and enterprise zones. I also want to thank Senator Boschwitz for chairing it.

I have been interested in this concept of enterprise zones for some time, and I am pleased to be an original cosponsor of Senator Boschwitz's bill on the subject. Enterprise zones offer us a fresh new idea in urban development. Instead of concentrating on providing inner city residents with food, clothing, shelter, and so on—as the Great Society attempted to do—an enterprise zone seeks to provide an atmosphere which will encourage inner city residents to depend upon themselves instead of upon Government assistance.

I firmly believe that Americans want to work but two Government policies have stood in the way: Prohibitive taxes and regulation have stifled business growth to the extent that jobs are scarce and no new jobs are being created. Also, Government assistance has become so pervasive that it has actually become more profitable not to work. The Great Society has not brought us prosperity; it has brought us only socially and economically depressed ghettos, and it is time to reverse this situation.

I believe enterprise zones lift the burden of Government intervention in entrepreneurship by creating an atmosphere conducive to the development of business activity where before there had been none. Through tax and regulatory relief on the part of Federal, State, and local governments, entrepreneurs will be encouraged to start businesses and jobs will be created.

Having learned that the wisdom of past legislators brought us to this crisis in urban planning, we must be very careful not to make the same mistakes that have been made in the past. It is imperative, therefore, that the question of how to provide incentives and which incentives should be provided must be addressed by those who will be involved in the product. Therefore, Mr. Chairman, this series of hearings by the Small Business Committee will allow those directly involved to speak out—the small businesses that will be creating the new jobs and revitalizing the depressed neighborhoods. With their thoughts, perhaps we can help them to help themselves.

Thank you, Mr. Chairman.

Senator BOSCHWITZ. Thank you, Senator Hayakawa.

Senator Tsongas, do you have an opening statement?

STATEMENT OF HON. PAUL E. TSONGAS, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator TSONGAS. Yes, Mr. Chairman.

Let me say that I appreciate Senator Weicker holding these hearings. I feel better about them this morning than I did last night at 1:30. I would only comment that I probably spend more of my personal time on the issue of cities and revitalization than, I think, any Member of the Senate.

We have what is called an economic development office in Massachusetts. Having lived all of my life in an old city and been involved with its decline and its resurgence, I would only add that many of the programs that are being criticized, like IDBs, CDBG, UDAG, and EDA, have worked. Anyone who does not believe that, I would be glad to take them on a tour of some of the communities in my State.

Yes, there have been problems. The mayors have not used CDBG very well. It has been used as a kind of political catchall, very much like CETA, in which people use CDBG to placate constituencies rather than for infrastructure development. However, the UDAG program has been remarkably successful, not in providing a cushion so much as leveraging in private sector investment. I would hope that the enterprise zones concept, which is still rather bleary in my mind but appears to have some merit, not be seen as a substitute for the other programs—some of which may go and others may stay.

However, I would say that the industrial revenue bonds, UDAG, CDBG, and other programs, are very worthwhile. Those of us who live in the industrial Northeast, who at least in my lifetime have experienced nothing but decline, are rather pleased by the resurgence taking place in many of those older communities. In my State, which has a lot of old cities, there is not one that has not shown some form of resurgence, some doing much better than others.

I look forward to these hearings which hopefully will try to flesh out what these zones are about and get onto it in this calendar year.

Thank you, Mr. Chairman. I would ask that my full statement appear in the record, in the interest of time.

Mr. Chairman, I would also ask unanimous consent that statements by Senators Nunn, Huddleston, Sasser, and Dixon be inserted in the record and that additional questions to the witnesses may be submitted in writing.

Senator **Boschwitz**. Without objection, so ordered.

[The prepared statement of Senators Tsongas, Nunn, Huddleston, Sasser, and Dixon follow:]

STATEMENT OF HON. PAUL E. TSONGAS, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Mr. Chairman: I am pleased to participate in this, the first in a series of hearings on enterprise zones sponsored by the Small Business Committee.

We have had the "concept" of the enterprise zones before us for a number of years now, and it is important that we go beyond the concept and get into the specifics.

1. If enacted this would be the first major new urban program since the UDAG program came into being in 1977.
2. The zones are being discussed at a time when our other major urban investment and revitalization tools are being threatened. We cannot divorce enterprise zones from the other programs: Industrial development bonds, UDAGS, CDBG, small business investment and EDA programs are all proven methods of stimulating new investments in cities and are crucial to the success of any new additional programs.
3. Enterprise zones need to be carefully examined in terms of the tax act enacted in the last session: The proposals so far have focused heavily on tax incentives, and we need to establish clearly whether these incentives are significantly different or better than those available to all business in the new tax act.
4. As time goes on, the initial questions about the enterprise zones have still not been addressed: What are the goals of the zones, and do the incentives provided address those goals. For instance: Will the tax incentives have any impact on the creation of new small firms, or do other factors play a more important role in stimulation of job creation in distressed areas? How can we address the priority need to provide access to affordable capital for small business?

Any discussion of enterprise zones quickly evolves into an examination of business investment and urban investment issues: The fundamental problems remain and cannot be skirted in the development of any new approaches, or we will have yet another failed urban experiment.

I am disappointed that we do not have any administration witnesses before us today, so that we can get down to the basics of defining the problem, and designing relevant solutions. However, I am pleased that we have such a distinguished group of witnesses before us this morning. David Birch from MIT has done historic work in the area of small business and central city job creation, and we have all learned a great deal from him over the years. Paul Pryde has advised the Senate for a number of years on business development issues, and was very helpful on the national development bank and EDA development finance programs where these same issues were addressed. We are fortunate that these witnesses are so patient and persistent in their efforts to point out what should be done and what should not be done to solve these problems.

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Mr. Chairman, these hearings on "influencing small business investments in enterprise zones" are extremely important. I want to complement you, and Senator Dixon, for taking the leadership role in putting these hearings together.

Enterprise zones represent one of the few new program initiatives in the President's fiscal year 1983 domestic budget. Although the specifics of the Administration's enterprise zone program have not yet been released (and there is some question as to whether the President will submit his own legislative proposal or endorse elements of several bills already pending in Congress), the Administration does estimate that their pilot program would have a $2 billion cumulative revenue loss over the next five years.

I am pleased that this Committee is becoming actively involved in the debate on enterprise zones. There seems to be a virtually unanimous view that the key to the success of almost any enterprise zone system is the ability of small businesses to succeed within the zones. I believe this Committee has the unique capability to piece together the various factors which we know impact on the potential success or failure for small business, and adopt them to the development of the zone legislation.

I have, and will continue to support economic development programs for our Nation's depressed areas. The Administration's support for a "free market" philosophy in the enterprise zone development program is exactly what I, and the Senate Small Business Committee, have been advocating for years.

But time after time, this Committee has seen that the "free market" has been somewhat reluctant to operate and fill the gaps in coverage that we know exist in so many areas of small business needs. Often, we have found it necessary to provide some types of incentive such as tax incentives or loan guarantees to encourage a particular private sector involvement. Many of the current legislative proposals recognize this gap in coverage and have designed various incentive schemes to influence small business growth in the proposed zones.

As a pilot program, enterprise zones have some appeal in contributing to the revitalization of our Nation's underdeveloped areas. But we must be clear that the enterprise zone concept which is being discussed in the Congress and the Administration is a "pilot" economic development program. I do not believe it is being offered as, and should not be viewed as, a substitute for other vital economic development programs which have already been successfully utilized nationwide. Most proposals do not even address some of the most important elements of economic revitalization.

Frankly, more questions have been raised about the potential implementation of any enterprise zone legislation than answers seem to be available. Today's hearings, and the additional Washington and field hearings that I hope this Committee undertakes, will provide us with answers to some of those questions which have been raised about the viability of any enterprise zone proposal. If legislation progresses to establish a pilot enterprise zone system, our task is to insure that the mix of incentives offered by governments at all levels (including the proposals to remove barriers to opportunities) is tailored to accomplish the purpose of the enterprise zone recommendation—job creation.

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM THE STATE OF KENTUCKY

Mr. Chairman, I commend you for scheduling these hearings on enterprise zones. There is no doubt that the economic decline of our inner urban areas is a problem which is in desperate need of a solution. The human misery which these decaying pockets of our society are producing can no longer be tolerated and must be eliminated. If it can be demonstrated that enterprise zones can effectively solve this problem, I will enthusiastically support any legislative effort to create them.

However, over the years we have seen many of these panaceas for the revival of economically depressed areas come and go. Some have had limited success while others have been little more than a waste of limited resources. Also, the concept of enterprise zones is basically untried and untested. At this time, its probability of success can be measured only by speculation and not by empirical fact.

For these reasons, I believe that we must be very careful in moving forward with this new concept. There are many questions which must be answered before we create another new Federal program. I believe that the hearing by the Senate Small Business Committee will enable us to begin finding the answers to these questions.

I have four areas of particular concern about the enterprise zone concept which I hope these hearings will focus on. First, many States have already embarked upon this idea by enacting their own legislation and others, such as my State of Kentucky, will soon do so. I believe that any new Federal program should compliment these State efforts rather than dominate them. Our goal should not be the creation of another Federal bureaucracy which imposes its will upon the State and local governments. Enterprise zones must be a partnership in the truest sense of the word.

Second, enterprise zones must not be used as an excuse to undo all of the health and safety legislation we have built up to assure decent and healthy working environments. Nor should it be used to force State and local governments to dismantle their laws. Some concessions can be made, but I do not believe that the Congress should abdicate its responsibility and give the executive branch a blank check.

Third, an enterprise zone program must contain some assurances that it will not result simply in a reshuffling of businesses from one area to another to take advantage of reduced taxes and regulation. We must be assured that before we spend several hundreds of millions of dollars in either tax expenditures or direct expenditures, that we will be generating new businesses.

Fourth, since small businesses create the largest percentage of jobs in this country, they must be assured of a key role in any zone program. This means that tax benefits should be geared to take into consideration the special needs of small business.

Mr. Chairman, I look forward to these hearings and I again commend you for having called them.

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE

The committee meets today to examine the likely role of small businesses in proposed enterprise zones. Such zones would be set up under various pieces of legislation, introduced in both the Senate and the House, in certain economically blighted areas. Mainly through the use of tax incentives these bills intend to encourage economic development of the zones that otherwise would be too risky for investment.

As in other instances of economic development, the primary intent of the enterprise zone concept would be to create jobs. And as the proceedings of this committee have repeatedly shown, the small businesses of this country are far and away the best job creators that we have. Firms with fewer than 50 employees, for example, created 77 percent of the new jobs in a recent 7 year period. Similar results have been reached by numerous other studies.

For this reason, it is important to the success of the enterprise zone concept that small businesses play a significant role in these development efforts. Several commentators, however, have questioned the likely effectiveness of the existing legislation if it continues to place what is referred to as an over-emphasis on tax breaks.

Businesses just starting up, for example, often do not show a profit for some time. Since tax breaks must be taken against income, such incentives are discounted by the new business in its early years.

In addition, it has been pointed out by other observers of economic development trends that businesses moving to new locations rate financial incentives low on their lists variables affecting decisions on location. Many other factors, it seems, have greater influence over their choice of a site.

Another aspect of the enterprise zone debate that should be considered is the effect of the zones on existing small businesses. As this committee is well aware, times have seldom been more difficult for the small businesses in our economy. Interest rates have reached record highs in the last several years. Government regulatory and tax policies continue to post a threat to small business vitality. Add to this a generally soft economy and record high failure rates and you have a mix that threatens to destroy this most productive and innovative sector of our economy.

We should be mindful that whatever enterprise zone plan emerges from Congress will impact upon thousands of existing small firms many of which are now struggling for their very existence.

I applaud the committee leadership for its efforts to convene these important hearings. The enterprise zone concept is an intriguing one that we will all hear much more about in the future. As I have said, small businesses will certainly play an important part of such plans. These hearings are, therefore very timely and I know will contribute greatly to the quality of the continuing debate.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

As a member of the Small Business Committee, I welcome the opportunity to explore the enterprise zone concept. Our hearings will afford us a chance to do more than explore the general idea of enterprise zones, though. They offer us a chance to get some specific answers to the many questions raised by the enterprise zone program.

Because small business is such a vital part of the success of enterprise zones, it is most appropriate that this Committee is taking an active role in obtaining specific answers to many of the problems which have not been explored in the creation of these zones. We need proposals on how we can improve the existing bills to insure entrepreneurs will be able to take advantage of the enterprise zone program. I hope the panel today will address the problem of how to make seed capital available, for unless such capital is available, the rest of the enterprise zone incentives are meaningless.

Another specific problem I would like to see addressed is that of coordinating the efforts of federal, state, and local governments toward the common goal of a successful enterprise zone program. How much control should the federal government have? Which regulations, both federal and local, should be eased, and to what extent? How can we solve the fundamental problem of making the zones safe for employers and employees? The answer to these questions will clearly effect the level of interest small businessmen will have in enterprise zones.

I look forward to hearing detailed answers on exactly what types of businesses are best suited to accomplish the goals of the enterprise zone program, and how we can target industries in enterprise zone legislation.

Scores of other vital questions remain. More hearings need to be held.

The Chairman has agreed to my request for a field hearing on enterprise zones in my home state of Illinois to be held in the near future in order to hear the views of local government officials and small businessmen. I encourage my colleagues on this committee to do the same.

Our initial hearing is the first step in the process of insuring that the vital interests of small business be protected in any enterprise zone legislation backed by the Administration. I am sorry that no one from the Administration appeared at our first hearing. I hope we have them at a future hearing. I would like to thank the panel for its time and for any answers they provide.

Thank you.

Senator BOSCHWITZ. Senator D'Amato, do you have any opening statement?

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator D'AMATO. Yes, Mr. Chairman.

First of all, I would like to commend you and Senator Weicker for initiating these hearings. I think that any strategy to revitalize the economy, especially the economy of our depressed urban centers, must place particular emphasis on job creation, especially in the small business sector.

It is important to have urban enterprise zones. However, if they do not concentrate on the development, the health and the expansion of the small business community, which is responsible for 80 percent of the job creation in the United States, they fail. If we do not give small business the tools to deal with the problems of adequacy of financing, expansion, et cetera, then even the urban enterprise zone is not going to solve the real problems that we face in terms of making our cities more livable and creating a quality of life that people can build upon.

Mr. Chairman, I think that is why these hearings are so important. We must focus particularly on the relationship between enterprise zones and small business and the very special needs that the small business community does have. Enterprise zones are designed to stimulate new economic activity in distressed areas which might otherwise not have occurred at all, anywhere, let alone in deteriorating urban neighborhoods. Through regulatory relief and tax incentives, enterprise zones will spur increased economic activity and generate new employment in targeted areas.

President Reagan has promised to send an administration-backed enterprise zone proposal to Congress this year. Since this draft legislation has yet to be formally released, I feel that it would be inappropriate to comment on any specific legislation at this time. I do want to make it very clear, however, that I am strongly supportive of the enterprise zone concept. We must restore strength to the

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economies of our blighted urban areas, and enterprise zones are an excellent mechanism for this needed revitalization.

With cutbacks in most other Federal programs providing aid to cities and to small businesses, enterprise zones are becoming the centerpiece of Federal urban policy. Thus, we on this committee must insure that enterprise zones are designed primarily to assist small, as opposed to large, business, for small businesses comprise the backbone of the American economy.

It is my hope that the administration, when preparing its enterprise zone proposal, will realize that tax abatement, in and of itself, is an insufficient incentive to attract new small businesses to depressed areas, and may not even provide enough incentive for those businesses already in these areas to remain there. The enterprise zone package should be multifaceted. It should also include regulatory relief, management assistance, zone-targeted small business, direct and guaranteed loans, job training, and some mechanism to induce State and local participation in this revitalization strategy. A proposal which concentrates primarily on tax incentives is not going to affect business decisions on locating or expanding in distressed areas. Concerns over public safety, condition of the urban infrastructure, availability and affordability of financing, and the job skills of the local labor supply are equally important factors.

The greatest economic problem facing inner cities today is the low and declining birth rate of businesses, especially small businesses. Not only are small companies, especially new ones, the most effective creators of new jobs in this country, but they also generate the types of jobs most suitable for inner cities. By providing beginning employment and job training for a largely young, unskilled work force, these businesses can play a crucial social role within the community.

However, these types of businesses are now shunned by Government agencies and large commercial lending institutions. Enterprise zones, by removing many financial obstacles in the way of an entrepreneur, may be the best way of providing an incentive for increased business investment in cities. We must provide the necessary encouragement to entice small businessmen to take financial risks in distressed urban areas.

I am delighted to be able to participate today.

Senator **Boschwitz**. Thank you, Senator.

Before we get to the witnesses, I would like to emphasize to my friend from Massachusetts that this is not seen as a substitute. As the author of the enterprise zone bill here in the Senate, I do not look upon it as a substitute. I look at it as another element for the purpose of achieving growth, not only in cities but the bill is so written as to accommodate the rural areas as well. That is an important aspect of it because certainly some of the rural areas are as much in need of that kind of help as the urban areas.

One other point: It is particularly appropriate that we hold these hearings this morning at the Small Business Committee because all reports of industrial growth, job growth, and job creation indicate that the vast majority of new jobs are created by businesses that look to this committee for some guidance and often for some help.

We thank all the members for their statements.

Senator TSONGAS. Mr. Chairman, if I may just respond, if the administration had the perception of the Senator from Minnesota, I would not have to raise the concern.

Senator BOSCHWITZ. Professor Birch, would you proceed?

STATEMENT OF DR. DAVID L. BIRCH, DIRECTOR, MIT PROGRAM ON NEIGHBORHOOD AND REGIONAL CHANGE, CAMBRIDGE, MASS.

Dr. BIRCH. Thank you, Senator.

Gentlemen, we have been studying over the past 3 years the behavior of 5.6 million business establishments during the 1970's, the vast majority of them being small. We focused particularly on the question of who creates jobs, and to make a very long story short because our time is very limited, we found that the major job creators in the economy now tend to be small. They tend to be young and they tend to be predominantly in the service sector.

We have done this for neighborhoods within 10 metropolitan areas. We found that the older the city and the more central and depressed the neighborhood—Senator Tsongas, you can relate to some of your neighborhoods in some of your cities in this context which are are also my neighborhoods and my cities—the more what I have just said is true. In the case of inner-city neighborhoods in older cities, the overwhelming share of jobs—in fact, in many cases well over 100 percent of the jobs—are created by small, younger, service-sector companies.

When I heard about Stuart Butler's initial concept of the enterprise zone several years ago, I thought it made an enormous amount of sense, and I still do. You set up an environment in which a small business can flourish, you try to encourage them in any way you can to create jobs in a productive way for the people in that zone.

There is no guarantee that it will work, so you do it on an experimental basis rather than on a full-scale basis, and you document carefully what happens. However, it is still as sensible an idea as there is around, and certainly in the context of our research findings it makes a great deal of sense.

I have become disturbed by what seems to be happening to the drift of the legislation over time, and I would like to mention a few of the things that are bothering me. If you ask small business what they want in a location, particularly an urban location, their priorities seem to be first what I might refer to as a civil environment.

In other words, running a small business is hard enough without having your employees mugged in the parking lot, without not being able to get insurance, without having your windows broken every other night, without having banks redline your neighborhood. That is a tough set of things to go up against in addition to running a small business in the first place. Businesses have plenty of other options; they do not have to go there.

The second thing small businesses will mention is access to capital, which dominated their recommendations to the White House Small Business Commission. The third, and a distant third, is favorable tax treatment.

As I look at the trend in the legislation, particularly some of the recent developments—and we will not know fully what the administration's bill looks like for a while—it seems to me the priorities are almost totally reversed. There is almost an obsession with taxes, and worse, with taxes that seem to be of little concern to small, young, growing service-sector businesses.

The capital gains tax, for example, is one that has a great deal of prominence in many of the bills. The vast majority of small businesses never capitalize on the capital gains tax. I did some calculations. The expected value of a capital gains tax incentive today, a dollar's worth of incentives, is somewhere on the order or 8- or 9-cents at present interest rates and discount rates and corporate behavior. Therefore, you are offering an 8 or 9 cent dollar when you offer a capital gains incentive.

Furthermore, with the current lowering of the capital gains rates across the country, the incentive is even less. The differences between what you are offering and what they can get on the regular market are lower still.

The investment tax credit assumes that you own a lot of things, and most young, small service-sector businesses do not own anything. They lease equipment, they rent office space, they have temporary accountants, they hire lawyers. They have very few assets.

Income tax incentives—in many cases small business people just laugh at you when you talk about income tax incentives. They do not make any money. The average small business takes 7 or 8 years to become profitable and the value of an income tax deduction 7 or 8 years from now is very small, at current interest rates.

The bills seem to be backing away from the only important tax that small businesses will talk about, and that is the payroll tax, the FICA tax, the social security tax. That is a tax that every business pays every year. That is a tax which, were you to give a credit against it, would be of enormous, immediate benefit to a small business. There has been very little mention of that because of some of the intricacies of taking general revenues and reimbursing the social security system for the losses to the social security trust fund.

The bills do very little in the way of helping to raise capital. We have already talked about capital gains, which does not do very much for many small businesses. There is very little in the bills for the private investor, where most of the small business money comes from.

Finally, there is no mention in any of the bills recently of the main concern of small business, which is a civil environment. There are no guidelines as to what a city submitting or proposing for the bill should provide in the way of a civil environment. The subject has hardly been mentioned.

It is no wonder, then, that the small businesses who are your main target population in the bill seem singularly uninterested in it, and that is a major concern of mine. If I read the hearings that have been conducted so far and talk to the associations, particularly those in New England, I find very little enthusiasm for the idea. As I talk to small business people directly, I have yet to find a single enthusiast for the bills as presently proposed. The National Federation of Independent Businesses recently has polled its membership twice, and they have consistently voted 2 to 1 against supporting it or in any way becoming involved with it.

Therefore, I sense a widening gap between the original intent of the enterprise zone concept as Stuart Butler has articulated it and as it has emerged in some of the initial bills, and the present direction it seems to be taking. I would hope very much in the months ahead that you would have many chances to listen to small business people in terms of what they would like out of the bill, and I think today is a very good beginning. You have several small business people coming in. There are many other opportunties in which you can poll their sentiments. Senator Tsongas, I know you have a group in Massachusetts that does this on a regular basis.

I think it is a very good idea to start listening much more carefully to your own constituency about this bill because if you do not, they will oppose it. They are presently opposed to it. Therefore, I welcome this chance for your constitutents to become actively involved in the deliberations on the bill.

Thank you.

Senator Boschwitz. Dr. Butler?

STATEMENT OF DR. STUART M. BUTLER, SENIOR FELLOW, NATIONAL CENTER FOR NEIGHBORHOOD ENTERPRISE

Dr. Butler. Thank you very much, Mr. Chairman, for the opportunity to testify. I have a prepared statement and a study on the British enterprise zone system which I would like to submit for the record.

Senator Boschwitz. Are you going to read your statement?

Dr. Butler. No, I was just going to make some comments based on it, particularly reflecting on the apparent shape of the administration's proposal. That proposal is a shadow over this committee in the sense that it is something which has no meat to it, and so we are talking to some extent in the dark.

However, I think that the administration's proposal as I understand it, fails to meet many of the points that Dr. Birch has just mentioned. I think that if it emerges in the form that it appears to be, it will fail. It has taken almost a year to produce and yet I think it is going to have the appearance of a Friday afternoon measure in not meeting the basic requirements of small business and the potential of the concept itself.

We must remember that the concept of the enterprise zone is certainly designed to encourage the development of small business in depressed areas. It is built on the idea of encouraging the potential of these inner-city neighborhoods to be brought into life, the factors of production that are dormant to become genuine, job-creating businesses.

It is very important, therefore, to look at the tax incentives that will tend to encourge small businesses to start in these areas. As Dr. Birch has pointed out, we know that small businesses have said repeatedly that Federal tax credits against corporate income tax are not an effective way of stimulating small businesses for the simple reason that most new, small businesses do not pay such taxes, and therefore a credit is not going to be helpful.

I understand that your bill, Mr. Chairman, does allow that credits can be taken in a refundable nature against payroll taxes. That would be helpful, although I understand that the administration is opposed to it and therefore the one aspect of the tax credit system that would help small businesses is, I understand, not going to appear in the administration's proposals.

It is very clear, also, that the key problem in addition to the civil environment that small businesses face is the acquisition of start-up capital. That is always, if not at the top of the list, certainly very close to the top of the list of the principal barriers to business creation, and particularly so in inner-city areas. It is very important, therefore, to look at incentives that will tend to encourage people to invest in such small businesses.

Now we have some evidence about the nature of people's decisions regarding investments, and one thread that runs through it is that, "a bird in the hand is worth two in the bush." People seem quite prepared to take very substantial risks in long-term investments, and put their money into commitments where they cannot touch that money, providing they obtain some incentive, some tax relief now, in this year.

We see, for example, people putting their money into IRA accounts, in some cases meaning that they cannot touch the money for 40 years, gambling that the marginal rate of tax they face in 40 years time will be less than it is now. I think people who had done that 40 years ago would be sadly disillusioned, and yet they are prepared to do this in order to get tax relief now. We find people putting their money into housing in order to get mortgage tax relief now, and gambling that the capital value of their house will improve.

People seem very motivated to take quite substantial risks if they are able to take a tax deduction in the current year. I think we should apply this approach to the enterprise zone. We should allow people who invest in an enterprise zone business—subject to a maximum and subject to keeping that money in the business for a minimum period, say 3 years—to deduct that entire investment from their income taxes.

This means that one is using tax incentives not to influence businesses as such but the investors in those businesses. We have strong evidence to suggest that this strategy will be effective, just as we have strong evidence to suppose that reducing the taxes on businesses as such, or trying to influence location decisions by businesses using tax incentives, is not that effective.

This idea has already won some support with some of the small business organizations. The National Federation of Independent Business has warmed to the idea of this mechanism as a way of dealing with the start-up problem of small businesses in enterprise zones. I understand that the Commerce Department's Minority Business Development agency task force on enterprise zones came to the conclusion that the idea of writing off or expensing an investment in a small business should be implemented in an enterprise zone.

I understand also that Senator Danforth has a measure of this nature in his rural enterprise zone bill, and as I mentioned in my prepared testimony, the British have instituted an experimental program along these lines, not just for enterprise zone businesses but in general in Britain. There has been considerable interest in this and it does seem to have led to a significant amount of new capital flowing into small businesses in that country. I have details of that legislation which I can make available to the committee.

Therefore, it seems to me that if we are looking at tax incentives as they can mobilize and motivate small businesses in inner city areas, totally new businesses, to start up, we must concentrate on incentives that apply to the investor to encourage him to take the high risk of providing capital to these small businesses, rather than to apply tax incentives that either try to help existing businesses to grow faster, or for that matter trying to encourage businesses to change their location decisions in favor of enterprise zone areas.

I think if we take that approach to tax incentives, we will find an incentive structure that will work effectively. It is unfortunate, I think, that the way the administration seems to be going along the alternative route, which is a route that has clearly failed in the past and has shown to be of very little interest to small business groups in this country.

Senator **Boschwitz**. Thank you very much.

One of the things that is in our bill is that we are going to have between 10 and 25 enterprise zones a year. Neither one of you commented on that. I have heard some comment that that is not enough, and I wonder what your thoughts are?

Dr. **Butler**. I think the enterprise zone approach should be seen as an experiment and therefore should be tested very carefully. An appropriate number is 10 to 25 per year. There will be obviously some cities that will be pressing for zones and will not attain them.

I think there is another reason, however, for having a limited number and that is that it is an essential feature of the enterprise zone concept to have the cities themselves providing incentives—particularly removing barriers at the local level. It is just in the nature of politics that it is necessary to have a limited number to insure that a certain amount of bidding takes place. I think that is an absolutely essential feature. I know that cities oppose that but it is the only way to insure that you get a genuine partnership between the Federal Government and the State and local governments.

Senator **Boschwitz**. What do you think, Professor Birch?

Dr. **Birch**. I would support what Stuart just said. I think if it comes out at 15 or 12 or 16, I would not be concerned. If it got to be 50 I would be very concerned, and if it were 3 I do not think you could do it.

One thing I would add is that there is very little, in any of the bills I have seen, very little attempt to document what happens. If this is a an experiment and a fairly large-scale one, it would seem to me appropriate to put something into the bill to make sure that we document—particularly since different cities will be trying different things—that we have some feedback on what happens. There is very little reporting back on the experiences that we have.

My concern would be that 3 years from now when we have the 15 alive for 2 or 3 years and somebody asks the question, "Well, what happened." There is nothing in the bill at this point that will enable us to answer that question, and I think it is an appropriate thing to consider. It may be analogous to the housing allowance experiments, where we in fact documented what happened as well as doing it, and we learned a great deal from that. I think it would be very important—given that this is an experiment, and I think it should be—to learn from it.

Senator BOSCHWITZ. I think that is a worthwhile suggestion. Professsor Birch, you have talked about the accessibility to capital lacking in in this bill, and while Dr. Butler gave us his view and Senator Danforth's, what is your view on what we should do in the bill to make capital more accessible?

Dr. BIRCH. Well, I would support what Dr. Butler just said. I think all the survey work I have seen on where smaller businesses, particularly younger, startup businesses get their capital, it is from private sources. It is from friends, relatives, savings accounts, aunts, uncles, local doctor investor groups, et cetera. If that is true, it seems to me our incentives should be addressed at those private investors to have them get their money out of money market funds and out of real estate investments and into small businesses. That is where the capital flow comes from for most of these businesses.

Incentives that would be attractive to the proverbial "Aunt Agatha," the private investor in the business, it seems to me should be the focus——

Senator BOSCHWITZ. Aunt who?

Dr. BIRCH. "Aunt Agatha" has become sort of a symbol of this private investor in some of these discussions, you know, the wealthy aunt who will put $10,000 into cousin Johnny's company. That is where most of the money comes from. I think the question you have to ask is, What do you do to make it attractive for Aunt Agatha to invest in cousin Johnny's company. I think some of the things Dr. Butler was mentioning are very appropriate: Giving her a short-tern incentive and a short-term writeoff to do that would be very, very interesting.

Giving her a 9-cent dollar in terms of a capital gains writeoff, does not seem to me to do very much for her. However, also allowing her to take any income—which many of the original bills did and some of the ones I am hearing about now do not—any income that she derives from that business and being able to deduct that on a fairly heavy basis against her own taxes would be a very attractive sort of a proposition.

I think you have to view it from an Aunt Agatha's point of view, not from say a bank's point of view or an insurance company's point of view or a large conglomerate's point of view, because that is where all the money comes from. I think one of your panelists later on in the morning, Paul Pryde, will talk in considerable detail about this and——

Senator BOSCHWITZ. I thought you were going to say that Aunt Agatha herself was arriving. [Laughter.]

Dr. BIRCH. You could do worse than to have a few Aunt Agathas testify at some of your hearings.

Senator BOSCHWITZ. Most Aunt Agathas that I have met do not invest in their nephews and nieces on the basis of a return but nevertheless, that is a different matter. That does not change the fact that perhaps some incentive can be given along the lines that Mr. Butler and you suggest.

However, if what you say is true, that it takes a small business 7 or 8 years to become profitable, I would have to advise Aunt Agatha not to invest and I would imagine that most other investors would not. I do not know where you come up with that. Maybe some studies——

Dr. BIRCH. Several surveys have been done in this country and other countries——

Senator BOSCHWITZ. I do not know any small businessmen that would have the staying power to go for 7 or 8 years on their initial capital. My initial capital would have lasted me about 6 or 8 months, not 7 or 8 years, if we did not begin to at least generate some cash flow. We did not know for a year if we were profitable or not. Recordkeeping was not good enough.

We tried, professor, to have an impact on FICA and other things that would be above the line, that would be part of the expenses that one would have to pay as a businessman whether or not you made a profit.

Dr. BIRCH. Right.

Senator BOSCHWITZ. The first bill that was introduced included that, and came into a great sea of objections. That particular provision was removed because of those objections and the pragmatics. It would be nice to make it such a sweetheart deal that the businesses would open very rapidly but unfortunately the pragmatics of our situation do not allow that.

Senator Hayakawa, do you have any questions?

Senator HAYAKAWA. Thank you, Mr. Chairman. I do have one that I shall address to both Professor Birch and Dr. Butler.

Professor Birch has used the term, "a civil environment," as essential to a flourishing business area, and Dr. Butler has talked about local building requirements and local regulations preventing an entrepreneur from establishing his company in his own basement or garage, local building codes, inspections and permits that are required by cities, and so on. All these stand in the way of the small entrepreneur.

However, these city and municipal regulations and the maintenance of a civil environment are all outside the area of Federal responsibility, are they not? They are the job of local government, and to have an enterprise zone at all, do you not have to have a substantial participation and agreement from State and local governments in order to get them started at all?

That means that you would have to lift some of the regulations about building codes and forbidding manufacturing processes in your basement or garage, or supplying an adequate police force or volunteer groups to monitor public safety in dangerous areas, that kind of thing. Are these not the product of either municipal government or local initiative, often on a volunteer basis? Can they be federally mandated?

Dr. BUTLER. I do not think that they should be required in detail. However, I think that the enterprise zone should be seen as a partnership between the Federal Government and local governments, and that therefore it behooves the local government to match the changes and encouragement that the Federal Government would be presenting through the enterprise zone legislation.

Therefore, it is quite reasonable within the Federal system to say that a city that is applying to have a certain area as an enterprise zone must also make some preparations within that zone aimed at streamlining regulations and encouraging business formations. It should not just say, "This is something that is coming from Washington."

Senator HAYAKAWA. Does the legislation that we are proposing to set up enterprise zones not allow for or require that kind of cooperation between the Federal and municipal governments before an enterprise zone is established?

Dr. BUTLER. Yes, it does. It requires a so-called local commitment. The administration's viewpoint, I understand, is that that will also be an ingredient in its proposals. There is, of course, on the one hand a desire to encourage certain kinds of changes at the local level. On the other hand, there is a desire not to interfere in local autonomy, and I think a fine line must be drawn between those two points.

However, if you consider the enterprise zone as an experiment, it seems to be more reasonable to suggest particular changes at the local level than you would do if it was a general program, available to all cities.

Dr. BIRCH. It was never my intention that it would be a Federal responsibility to deal with these things. It is more that as you turn this over to the administration for execution, there be some guidance as to the basis on which cities would be selected or not selected, and there should be some guidance as to the importance of these issues to the small business community as part of the evaluation process for selecting and evaluating other proposals that come before the administration.

At the moment, the bills remain silent on this other than saying that the local government should become involved. It is so clear from our discussions with the small business community that these things are of such vital importance to them, it seemed to me from the point of view of your constituency it would be important to at least somehow articulate to the administering agencies that these are important considerations in choosing proposers.

To me a city that came in and mentioned not one of these in its proposal should receive very short shrift in the evaluation process. That suggests that maybe we could encourage the success of the concept by giving some guidelines as to what at least a minimal set of considerations should be.

Senator HAYAKAWA. Well, I am not sure to what degree such guidlines can be written into the legislation setting up the enterprise zones. It would seem to me that in the language that accompanies the law you could very well set up guidelines but I do not know that it would be necessary to write it into the law itself.

That is a technical question. There is one other question I would like to ask both of you. One very, very important matter is that young people looking for their first job—inexperienced in any trade or occupation, never having had a job before, sometimes high school dropouts, whether for academic or economic reasons—are required by law to be paid this year $3.35 an hour, and many of them are not worth $1.10 an hour with the experience and work discipline they bring to the marketplace.

I have been interested for a long time in this whole matter of youth unemployment. When I first came to the Senate, the unemployment rate among black teenagers was something like 30 to 35 percent. With the constant rise in the minimum wage which applies to young people no less than to adults, the minimum wage now is $3.35 and this past year the unemployment among black teenagers has gone up to 50 percent.

The situation gets worse all the time, whereas if you look back to labor statistics of just a few years ago, you find that the unemployment rate among black teenagers in 1949, 1950 was lower than among white teenagers. At that time the minimum wage was so low as not to affect the outcome of the young person's search for employment.

Well, what is the alternative for, let's say, a 17- or 18-year-old who is not hired because of legal restrictions as to how much he must be paid. There are not many alternatives except to hang around in the streets, and hanging around in the streets leads to trouble, crime, and all sorts of things. Also, it delays his adulthood and delays his becoming an economically self-dependent unit in the community.

Now I wonder if you have given any thought to exempting enterprise zones from, for example, the requirements of minimum wage laws as they now apply to all labor?

Dr. BIRCH. I think it would be very important to talk with the small business community about this.

Senator HAYAKAWA. Well, that is very easy to do.

Dr. BIRCH. Yes.

Senator HAYAKAWA. You take, for example, fast food outlets. They have been the principle employers of inexperienced teenagers, and then if they show any promise at all, by the time they are 17 or 18 years old they put them into management training.

Dr. BIRCH. There was a hearing in Boston where this question was raised and small business people discussed it. The sentiment there—and I would much rather have them speak for themselves——

Senator HAYAKAWA. Yes.

Dr. BIRCH [continuing]. Was that they would rather pay the minimum wage, receive a payroll tax credit, and have the value of a minimum-wage person, rather than paying a lower wage which effectively was not competitive with welfare payments. In other words, you are constantly competing with a welfare system whose payments themselves are rather substantial. The sentiment that I heard the small business people express was that they would rather pay that $3.35, get an FICA tax credit of, say, 40 or 50 percent as a training incentive to make those people worth $3.35, than to try to pay them $1.10 an hour and attract them out of the welfare system.

That was a sentiment that was expressed in that Boston hearing, and I think as your hearings with the small business community go on further, that would be a question I would address to them and ask them, "Would you rather pay the $3.35 and create $3.35 worth of value, or would you rather start low and work in some other way," the sentiment that I heard them expressing was the opposite. They would rather compete effectively with the welfare system and use a tax credit of some kind to create the value.

Stuart, do you have any——

Dr. **Butler**. Yes, I think I would tend to agree with that but the factors that have increased the youth unemployment, particularly among minorities, involve both the minimum wage and the relative attractiveness of the welfare system. Eliminating minimum wage would only deal with one part of that, of course.

I think, however, in the enterprise zone it would make sense to provide "on offer," so to speak, a subminimum wage or no minimum wage to cities that were willing to experiment with it in an enterprise zone. We are talking about siting these zones in areas with 40- or 50-percent unemployment. Even if some of the objections to removing minimum wage suggested by organized labor prove correct, you could hardly create more damage than we already see in these areas, so I would think that in terms of applying the minimum wage or no minimum wage to an enterprise zone, it should be a sort of an optional extra. If the city and the State both request that to be an added feature of the zone, it should be available.

I think, however, that if you put that in the legislation and required applicants agree to either no minimim wage or some minimum wage, that we would find such hostility to that in many of the areas that really need enterprise zones as to divert the discussion from the central features of the concept.

Senator **Hayakawa**. Well I certainly would not believe in requiring that. I have been thinking not of a minimum wage far, far below the adult wage of $3.35--I was not thinking of $1.10, for example--but in the British labor movement there is a youth minimum wage of 15 or 20 percent under the adult minimum wage, and the adult worker feels it is an insult to his pride that a lad should get the same wages as a man.

Therefore, if you are lifting all sorts of other restrictions like building codes and other things, in order to permit the small businesses to survive in an enterprise zone, this alternative also ought to be one of the options available, should it not?

Thank you, Mr. Chairman. I think I have taken more than my share of the time.

Senator **Boschwitz**. Senator Tsongas.

Senator **Tsongas**. Mr. Chairman, I will be brief. Let me begin by recognizing Wyche Fowler, my colleague in the House, who I understand will be introducing one of the members of the next panel.

I think it is obvious that everyone is in accord that the enterprise zone notion has merit. The disagreements come on the particulars. Can you tell me what interaction either of you have had or are having with the administration as it puts together its package?

Dr. **Birch**. Stuart has had——

Dr. **Butler**. I have made suggestions from time to time, to the Cabinet Council that has been discussing the idea over several months, to the Treasury and to the Department of HUD.

Senator **Boschwitz**. Pardon me, Dr. Butler.

Would you repeat that question. It was very brief, and I am sorry, I did not hear it, Senator.

Senator TSONGAS. I was asking, since there is basic accord as to the concept and the argument tends to be on the particulars, I just wanted to know what kind of exchange each of them has had with the administration as the administration proceeds to put together its package?

Dr. BUTLER. As I said, I have had frequent communication with the administration on this and I know several options have been under discussion by the administration from time to time. My remarks at the beginning of this panel referred to what I understand to be the general drift of the decisions have been made with regard to the enterprise zone.

The idea of allowing investors to expense or writeoff the entire investment in the first year, I know was considered by the Treasury and they brought up various technical objections to it. However, much of that consideration took place before details of the British mechanism were available, and I think we find that in the mechanism applying in Britain—which seeks to do exactly the same thing as I am suggesting here—many of the objections that the Treasury did bring up are dealt with.

The fear in the Treasury, I believe, was that there would be various kinds of exchanges of money without any real benefit in terms of new businesses being formed. The British have taken care of that by various methods which would be appropriate in this country.

The other fear the Treasury has generally had has been almost an obsession with the possibility of losing revenue. This is probably quite understandable considering the kind of pressure that Mr. Stockman is under but if we look at the nature of investments normally made by small investors that would be attracted to this expaning mechanism it would tend to be money that would not be taxed at the highest level anyway. The investors would be choosing between taking the risk of supporting a friend or neighbor or relative, as opposed to putting their money into another form of investment which was sheltered in some degree from tax.

Therefore, I think some of the calculations that the Treasury made as to the cost of any kind of writeoff procedure ignored that relative difference of tax treatment. I think also, of course, that if we are talking about creating new businesses—which the enterprise zone clearly is intended to do—and bringing people off welfare into employment, that the benefits are very considerable even if some tax losses were involved in an expensing provision.

From my discussions with the administration, therefore, it is something that they have considered, and as far as I know have rejected, but I think rejected for the wrong reasons and in ignorance of some of the evidence available from another country using the mechanism.

Dr. BIRCH. Stuart, being here in Washington and kibitzing on a regular basis, has been much closer to the administration thing than I have. My only observation would be that the differences the Treasury is bickering over are relatively small. I jokingly said one day that we are talking about the left wing of a B-1 bomber being the total area of disagreement in the entire legislation.

It would seem to me that it would be appropriate to raise some questions about relative magnitudes here. In an experimental program, in an enterprise zone concept, we are talking about relatively small amounts of money by Federal standards. It seems to me the values to be gained by experimenting with a variety of proposals—not unlike your original FICA deductions and not unlike some of the investment incentives that have been discussed here today—would far outweigh the relatively minor differences in revenues involved.

I know this is not a time to take any revenue loss lightly. On the other hand, the possibility for experimenting with a wide range of options seems to me quite valuable relative to the differences involved.

Senator TSONGAS. Well, when we passed Kemp-Roth we took revenue losses heavily, not lightly, so there is precedent for doing that.

I would just like to say in conclusion that it seems to me that there is no consensus as to how you do it. It is just experimental, and I would hope that any legislation that we finally pass would be broad enough so that in the various communities we can plug in different proposals and see how they work, one against the other. They are all the same. You never really know which of the particular ingredients has the desired impact and I would hope that we would be experimental, which means some flexibility on the part of everybody. Obviously everybody has some objection to something but if we are going to try an experiment, we should try an experiment, and I would hope that that would be the case.

The final point I would make is, I would hope that the small business community, which has expressed its concern to me as well, would come up with alternatives. This is a good concept. Tell us what would you like to see in it, rather than just voting 2 to 1 against it. That does not get us very far. That is why holding these hearings is such a positive step, I think.

Dr. BIRCH. This is the final, final point I would make: This is the first forum I have been to in a long time where an experiment of Mrs. Thatcher was commended. It may be a long time before I have the experience again. I just want to make a note of it while it happens.

Senator BOSCHWITZ. Senator D'Amato?

Senator D'AMATO. Thank you, Mr. Chairman.

I have to commend the panel, particularly Professor Birch. I have never heard it put quite so nicely as when you talked about the civil environment that is necessary to sustain a trivial busines community. I cannot help but agree with you. I do not know if my colleague really thinks that he spends more time in urban centers than any other person in the U.S. Senate. That is quite a boast. I would like you to come to the South Bronx with me some time. Maybe one day there will make up for all of our other days that some of the other colleagues do not spend in terms of time.

You will get an experience in a life style that will show that any urban enterprise zone that does not take into consideration exactly what was said about providing the civil environment necessary for people to come to work, to work there at all hours—because the successful entrepreneur then who wants to stay and is forced to stay or put on another shift, et cetera, finds it is impossible to do that—will fail. It takes considerably more than just giving tax incentives and tax breaks to create the kind of atmosphere that will make it possible for business to develop and to flourish.

Therefore, it seems to me that a very necessary component of the program will be some kind of guideline—I am not suggesting the form of the legislation—that will definitely encourage local governments to provide a more stable environment, particularly if this is going to be an experiment. I think, at first, we should only pick a limited number of enterprise zones that will give very high priority to that local effort to guarantee the necessary police, fire, and sanitation services, et cetera, to create a civil environment that will attract people and business.

Businessmen, given an alternative of having to worry about the problems of crime, et cetera, that do exist, will opt to go somewhere safer, even if it is more costly. Without a minumum guarantee of security, they will not worry about some future tax break that they are going to get. Survival is the key.

Therefore, I would just like to make this observation, Mr. Chairman. I think the panel touched on something that is very important. You can give all the tax breaks in the world yet you are not going to get the small business entrepreneur to relocate in an unsafe environment. You may get some larger corporations to come in try to create their own environment. They would have been investing capital in any event some place else, and so there is really no real national gain.

Do you think that you can set up criterion to insure civil environments in enterprise zones?

Dr. BIRCH. Well, actually some of the wording I have seen in some of the proposals has attempted to do that from time to time, talking about the importance of neighborhood self-policing groups. Attempts have been made in this general arena to begin to do that. I think it is something you should talk to the small business community about. The National Federation of Independent Business just published a study by Thomas Dandridge looking at what their concerns and needs are.

I think you could solicit them within the context of this committee and begin to come up with at least an articulation in the legislation, perhaps if not in the form of regulation, in the form of guidance to the administration as to what are some of these concerns that your constituency has, and that proposers to the administration for execution of this concept should take it into account, when they evaluate competing proposals. That would give the local cities some incentive to think about these issues and not just about the tax breaks.

How you do it technically in the legislation, I will leave to your discretion. I think it is the concept that I want to communicate.

Senator D'AMATO. Well, unless these requirements are part and parcel of the selection process, then we are going to do ourselves a great disservice. I think that, initially, enterprise zones should be relatively few in number so that we can monitor results. If you are just going to take an area that has declined in business, but not require mechanisms to deal with the kinds of problems that exist in most of our inner-core cities—such as are the loss of the civil amenities, crime and, public safety, then you may create a pocket where some companies do come in and there is a general pick-up, but this it is not a real solution. It would not be sufficient as a program to address the problems in our urban centers.

Dr. BIRCH. That would be my concern, and it is the concern articulated by most of the small business people I have spoken to.

Senator D'AMATO. Well, I thank you very much for your viewpoint.

Senator BOSCHWITZ. We thank the witnesses. I might say we tried to incorporate some of these guidelines. We understand the necessity of a civil environment but we found that in trying to establish some of these guidelines, we were up against local statutes and State constitutions. We would exempt some States and localities from participating if we required certain real estate tax advantages or other things.

Quite clearly—and we do not need a lot of testimony about it—no business is going to locate if there is not adequate police and fire protection and if they cannot buy insurance. Therefore, that has to be part of the bid. The committee report on the bill discusses those kinds of things. I hope we do not rehash that all morning long.

We will have some guidelines. We will have a good deal of talk on the Senate floor which will indeed establish some guidelines. It would also be my hope that not only the South Bronxes of the world but also some of the areas that are not in such desperate shape also have some enterprise zones, so that we see how they work at various levels.

I think your idea of putting something into the bill to monitor the results is a useful and constructive idea. The various ideas with respect to capital are helpful and have been considered. We had tax credits because of the FICA. We could not get the FICA in. That really presented a lot of problems with a number of our colleagues so we put in a refundable tax credit. That presented some problems with the administration. Perhaps with your help, Dr. Butler and Professor Birch, we can hassle around a little bit with those folks and improve this legislation. We thank you very much for coming and your testimony was indeed helpful.

[The prepared statements of Dr. Birch and Dr. Butler follow:]

THE PREPARED STATEMENT OF DR. DAVID L. BIRCH

SMALL BUSINESS AND THE ENTERPRISE ZONE

The creation of jobs is an obvious concern of any city caring about the well-being of its people. Having discovered some broad national and regional patterns in previous research[1] on the job generation process, the MIT Program on Neighborhood and Regional Change has also looked at employment growth and decline within specific metropolitan areas at the neighborhood level.[2]

Our raw data source has been the Duns Market Identifiers (DMI) file created by the Dun and Bradstreet Corporation. At any given instant, the file contains records for about four million business establishments nationwide (about 80 percent of the total number of such establishments). We merged the records for each establishment for 1969, 1972, 1974, and 1976 to obtain a history of the development of each establishment during the 1969-76 period. In the process of merging, we added new firms that were formed along the way, yielding a total file of about 5.6 million establishments for the seven-year period. We also edited the merged records to eliminate all establishments about which there was any question about the validity of the data.

The ten cities selected for detailed analysis were Boston, Worcester, Mass., Hartford, Conn., New Haven, Conn., Rochester, N.Y., Dayton, Ohio, Baltimore, Charlotte, N.C., Greenville, S.C., and Houston.

After analyzing the city data for relationships between job patterns and intra-city business locations, types of neighborhoods, types of businesses, and population density, we can draw some general conclusions regarding jobs and civic economies. One important finding is that most places lose about the same percentage of their job base each year -- about 8 percent a year. Turnover is consistently a natural consequence of entrepreneurial activity. The culprit in declining economies is not job losses but the absence of new jobs to replace the losses. Boston and New Haven are not losing more businesses and jobs each year (in percentage terms) than Houston. In fact, Houston is losing slightly more. The difference between Houston and New Haven or Boston is that Houston is attracting a much greater share of new businesses and expansion of existing businesses. It is Houston's strong offense rather than Boston's or New Haven's weak defense that is making the difference.

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[1] See Birch, The Job Generation Process and Choosing a Place to Grow (MIT Program on Neighborhood and Regional Change, 1979 and 1981 respectively)

[2] See Birch, Job Creation in Cities (MIT Program on Neighborhood and Regional Change, 1980)

Development strategies aimed at holding a thumb in the dike -- trying to reduce losses by holding onto firms -- would appear to be as futile as telling the tide not to go out. The tide appears to be going out everywhere at about the same rate -- a conclusion that we drew previously for all areas within the United States as a whole. What New Haven and Worcester and Boston are not doing is attracting enough new, replacement jobs to compensate for their losses.

When we looked carefully at the competition these cities are engaged in, we noticed a certain perversity in the pattern of replacement. The older, declining cities were built during the Industrial Revolution. Their growth was based on large manufacturing companies that thrived on the city's harbors and hydroelectric power and skilled labor forces. Many business people and politicians in these areas have grown accustomed to the notion that large manufacturing plants are the key to a city's economy, because historically they have been. A new pattern is emerging, however. The large manufacturing plants are now moving to the growing areas that (in an Interstate world) are closer to markets, have adequate power (from petroleum, coal, gas, and electricity), and offer warmer climates. At the same time, smaller, service-oriented jobs are building in the older cities. Perhaps it's because the well-established universities in these areas produce graduates who wish to work for knowledge-based organizations such as hospitals, universities, financial institutions, consulting companies, computer software houses, market research firms, and so on. Perhaps it's because many of these older areas have become financial centers that attract banks, insurance companies, brokerage houses, and all the services that come with them. Perhaps it's because many older cities offer cultural opportunities and a variety of facilities that make them attractive to tourists and convention-goers. Boston's Quincy Market, waterfront, ball park, museums, symphony orchestra, and hotels collectively offer a visitor a great deal. Together they also spawn a large number of service and retail jobs.

Whatever the cause, it is clear from the figures that the only source of net new jobs in older areas is in smaller businesses, and that most of these are in the trade and service sectors rather than in manufacturing. The slower a city is growing (or the faster it is declining), the more this trend seems to hold true.

This source of strength in older cities poses some particularly difficult issues for those who would like to nurture it. Economic developers have traditionally thought in terms of direct assistance to individual businesses. When those businesses are large and few in number and easily identifiable, direct assistance makes a great deal of sense. It is also politically attractive, because a granting agency can point immediately to its successes.

A problem arises, however, when a target population consists of thousands of small businesses. They are diffcult to reach. They are expensive to aid -- the set-up costs are high relative to the magnitude of the assistance provided. They can be embarrassing -- they fail often, and agencies cannot tolerate many failures. But most frustrating of all, by and large small businesses are not asking for and do not want direct help. When polled at a recent White House Conference on Small Business, the overwhelming majority of participants asked that tax laws be reformed to permit small businesses to gain and retain capital more easily. Among the top sixty recommendations, not one suggested direct economic assistance (such as loan guarantees, interest subsidies, or grants), and the general tenor of the recommendations suggested that the less government agencies became involved in their affairs, the more small businesspeople would like it.

The Enterprise Zone concept is an attempt to break away from the pattern of direct assistance and instead to assist smaller businesses indirectly, by providing an attractive climate and capitilizing on smaller businesses' ability to flouish in such a climate.

A sustantial number of different Enterprise Zone proposals have been made, each with a different set of incentives. But there has been a disturbing drift in these proposals over time -- disturbing, that is, if the intention of the Zone is to encourage small businesses. My own discussions with small businesses and small business groups suggests that what a young, growing, job creating business needs most from the world around it, in order of priority, are:

1. A "civil" environment
2. Help in raising capital
3. More favorable tax treatment

Of these three, a civil environment is by far the most important. Starting a small business is hard enough without having to worry about muggings in the parking lot, availability of insurance, vandalism, and red lining by banks. Favorable tax treatment, in contrast, is a distant third because so few young, expanding businesses make any taxable profits at all in their first few years.

Most recent bills seem to have reversed these priorities. They are obsessed with tax breaks, most of which are of little value to the expanding small business. The only tax credit of substantial value would be a payroll tax credit (because smaller, service sector businesses are labor intensive and pay substantial payroll taxes each year), but payroll tax credits have gradually vanished from the scene because of the complexity of dealing with the social security system.

The second issue -- capital formation -- has also drifted in the wrong direction. Most young start-up businesses get their capital from private sources: savings, friends, relatives -- the proverbial Aunt Agatha. Recent bills, in contrast, do little to attract Aunt Agatha into the Enterprise Zone. They focus, instead, on reduced capital gains taxes, the benefits from which are realized only in the distant future for those few businesses that (1) survive, and (2) appreciate in value, and credits on interest payments for the handful of banks that will make few if any loans in an Enterprise Zone.

Virtually all bills are silent on the main concerns of small businesses: a civil environment. They apparently leave it up to the proposing city (with no guidelines whatsoever) to grapple with the issues of insurance, crime, red lining, etc.

It is no wonder, then, that the very target of the Enterprise Zone concept -- smaller job-creating businesses -- are singularly uninterested in the proposal. My reading of previous hearings evidences little enthusiasm. My personal polling of businesses and associations in the Boston area has yet to uncover a single enthusiast. And according to William Dennis, research director of the National Federation of Independent Business, two recent polls of NFIB's membership both produced 2 to 1 votes against supporting Enterprise Zones.

In summary, a widening gap is emerging between the original concept of the Enterprise Zone (as articulated by Stuart Butler) and its manifestation in present and proposed bills. This gap has become so large that the Zone's target group (the small, growing business) is, at best, indifferent to the idea and, at worst, opposed to it. Under these circumstances, formulators of legislation in the months ahead must either start listening much more carefully to the small business constituency that they intend to embrace and draw upon, or abandon the concept altogether.

United States Senate
Committee on Small Business

Presented by:

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February 25, 1982

The views I am about to present are my own and do not necessarily represent those of the National Center for Neighborhood Enterprise, where I am currently in residence.

When exploring appropriate mechanisms to create enterprise zones in this country, it is important to remember the elements of the concept. I have been working on the concept for three years, both with the National Center for Neighborhood Enterprise and The Heritage Foundation, and have noticed a marked propensity among those fashioning the details of possible programs to lose sight of the objectives of the enterprise zone. From my understanding of the Administration's proposals, they be yet another example of the means being contradictory to the objectives of the concept.

There are three releated elements embodied in the concept.

Firstly, the enterprise zone rests on the assumption that within even highly blighted areas of our cities there is enormous potential for economic development. We know, of course, that certain factors of production exist in abundance. There are plenty of underutilized or abandoned buildings that could house fledgling enterprises, and there is no shortage of labor, albeit largely unskilled. And it is equally clear, from the existance of often quite strong underground economees--to say nothing of criminal activities of a more objectionable kind--that there are people willing to take risks to gain economic rewards. Proponents of the enterprise zone argue that excessive government regulations and tax disincentives have frustrated legitimate business activity, and forced many entrepreneurs either to give up completely, or to go underground. By creating a new climate, consisting of more appropriate and relaxed regulation, together with incentives for risk-taking, the enterprise zone would seek to develop an environment which would encourage the potential of depressed areas to be turned into the reality of new businesses.

It follows from this that the enterprise zone concept is designed to lead to the creation of new firms, not the relocation of firms already in existance. In this regard it differs from many state policies, which aim to draw companies to one state from another. The concept, in other words, sees inner city development as an addition to the national economy, not a rearrangement of it.

Seen in this way, the enterprise zone concept must emphasize small firms, since it is rare for a large, independent, corporation to appear as a totally new creation, rather than as a branch of an existing company. This view of the enterprise zone also has tax revenue implications. If reducing the rate of tax leads to new taxpayers appearing in a blighted area, rather than to businesses moving in from elsewhere, it would mean an increase in tax revenue. It is, after all, better to receive 50 percent of something than 100 percent of nothing.

Secondly, the enterprise zone should foster a climate of adaptation and innovation, both by business in the zone and by neighborhood organizations providing services. It is not the purpose of the zones to provide a life-support system for obsolete industries, but rather a stimulus to entrepreneurs seeking new products and services which fit the potential of the area. We are more likely to find the most appropriate goods and services if we encourage many small firms to start than if we place all our hope on one major firm. Similarly, we are more likely to find the best range of security, day care, training and other services if we dismantle obstacle to the many neighborhood organizations that exist in distressed communities than if we try to provide them from outside.

Thirdly, the zone concept sees the creation of locally-owned businesses as being as important as the provision of jobs for local people. A strong local business community is vital to the stabilization of a neighborhood. Local owners have a stake in the community, and provide a positive role model for others. They are also able to cooperate with neighborhood groups, and gain the loyalty and trust of residents in a way which is difficult for owners who reside elsewhere.

Each of these elements implies an emphasis on new, small firms. In designing the enterprise zone, therefore, we must consider the obstacles and disincentives that small businessmen cite as impediments to company formation in the inner cities.

Many surveys have been taken of small firms, to ascertain these obstacles. In addition to testimony from small businessmen, I understand the committee will be hearing from witnesses familiar with surveys conducted by the National Federation of Independent Business and the Commerce Department (the latter covering minority businesses). I will leave the full details of those findings for others to explain, and only comment on the broad results. I would, however, caution the committee to distinguish between the problems noted by owners of mature small firms, or those contemplating a return to the inner city, from those identified by the proprietors of recently-formed companies. They are often very different (most notably regarding tax burdens) and it is the latter group that really concerns us.

If there is one thing that stands out as a crucial problem for new, small companies it is the acquisition of start-up capital. Companies in depressed areas also cite crime, the lack of workers with basic job skills, local inspection standards and insurance costs among the major barriers they face. However taxes (other than payroll taxes) are usually well down the list of start-up headaches. Most small, new firms are in operation for a number of years before they face a significant income tax burden.

If an enterprise zone is to be a mechanism to reduce these barriers it must therefore accomplish two things. It must set in motion a process of change that allows and encourages an improvement in the social conditions in the area, with a view to reducing the incidence of crime, improving cooperation between businesses and residents for mutual benefit, and generally reducing the risks associated with business formation. The zone mechanism must also reduce the start-up capital problem for firms by reducing unnecessary costs (and hence the need for capital) and by altering the tax treatment of capital to restore the incentive to take risks in the inner cities.

To improve the social environment for inner city businesses, we should build on the remarkable successes of neighborhood organization. In cities across the nation, they have managed to cut crime by mobilizing residents, to provide day-care centers which enable mothers to work, to screen and to discipline young workers for entry-level positions, and to deliver security services for local businesses. Not only have these groups generally provided such services without significant assistance from government, but usually the misguided interference of government has been their greatest frustration. Outdated zoning restrictions have often prevented day-care centers from being established, or forced them to operate outside the law; occupational licensing procedures have prevented adequate services being delivered by local people; and local government officials typically have sought to control and direct neighborhood efforts, instead of encouraging unorthodox, but effective, local initiatives.

In designating enterprise zones, the federal government should insist that local governments dismantle regulatory barriers to innovative community organizations. Such organizations have a direct stake in the success of the zones, and they have shown themselves willing and able to take a lead in dealing with the social deficiencies of their communities. As the President has noted, voluntary associations have formed the backbone of successful communities throughout the history of the United States and developed "public/private partnerships" long before the term became associated only with corporate boardrooms and city halls. Allowing these community groups far greater freedom to respond to the social needs of the inner cities must be a key ingredient of the enterprise zone strategy.

The issue of start-up capital requires, in part, a similar appraoch. The cost of establishing a business is increased when local regulations prevent an entrepreneur from establishing his company in his own basement or garage, or force him to make expensive structural changes to comply with the fine print of the building code. The city can also cost him dearly by delays in inspections and permits, or by taxing him heavily before he has a chance to earn significant income. All these delays and direct costs push up the capital needed to commence operations. By reducing these burdens, and giving the firm a breathing space to get started, the capital required can also be reduced.

In the designation process, therefore, the federal government should ensure that local governments do everything possible to stremline local zoning, code and other regulations pertaining to the establishment of businesses in the zones, and to speed up the permit procedure. Several cities have already moved in this direction, and the savings for new firms have been significant.

Even when everything has been done to reduce the unnecessary costs facing new businesses, these firms still have to obtain capital. Traditionally, new, small firms obtain most of their finance either from personal savings or loans from friends or neighbors. It is rare for someone starting his first business to obtain the funding from an institutiona lender. There are good reasons for this. Institutional lenders are not so willing to take risks as informal lenders. The overhead cost of processing a small loan, compared with a large loan, make it unattractive to a bank. Political pressure to show results makes even government bodies, such as the SBA, extremely cautious. Informal lenders, on the other hand, are generally more willing to take risks and support their neighbors. They are motivated differently

Unfortunately, changes in the tax code, enacted over many years, have steadily reduced the attractiveness of new business ventures as investment opportunities for small investors. We have an array of devices available for those who once funded small firms--IRA accounts, tax-free savings, interest deductions on homes and many others. Few of these instuments encourage a flow of funds to small companies, let alone small firms in depressed neighborhoods.

To encourage a flow of capital to new enterpise zone firms, we should take note of an interesting phenomenon associated with decisions made by small investors. That is that small investors prefer a bird in the hand to two in the bush. People are quite willing, for example, to gamble on the future value of a house if they can deduct the mortgage interest now. They also seem quite willing to set up IRA accounts, and gamble that their marginal income tax rates will be lower in thirty or forty years time than they are now, in order to take a tax deduction this year. The pattern is very clear: small investors have short time horizons, they are very willing to take long term gambles if there is a short term incentive.

We should apply this to the enterprise zone. If investors in new enterprise zone firms were allowed to deduct the entire investment from their taxable income (subject to a maximum of, say, $25,000), provided they kept the money in the firm for a minimum period, I have little doubt that there would be plenty of people willing to take the risk that the firm might fail or that a reasonable return on the investment might be long delayed. A mechanism of this kind would be far more effective at generating capital from the traditional sponsors of small firms than devices such as reducing capital gains or the incidence of tax on interest and dividend income from loans.

It is important to reflect on what a tax mechanism of this nature is designed to achieve, in light of what we know about tax incentives and business formation.

In the first place, the mechanism is not contradictory to evidence suggesting that tax relief is not useful for new, small firms because they do not have a severe tax burden. The incentive is aimed at the investor, not the business. and it is designed to deal with the problem of start-up capital, not business taxes. Secondly, it is not an incentive designed to get businesses to move to inner cities. We know that businesses are not very sensitive to state tax changes when they pick a site. This mechanism does not run counter to those findings. What it does do is help entrepreneurs who are trying to start operations in the inner city--chiefly local people. We know from studies by NFIB and others that small businessmen tend to look at their own neighborhood first when picking a site for their first firm. The choice is not usually between going into business in that neighborhood or some other city or state, but starting there or not starting at all. The mechanism suggested would bring capital to those potential local businesses, not act as an incentive to get outside firms to locate in the zones. It is, in other words, a device designed to influence th flow of capital, not the location decisions of transient corporations.

It should be added that the British have recently launched an experimental program to help small business generally, which involves a one-year expensing provision for investors along the lines I have suggested for enterprise zones. Although only six months old, it has led to a healthy flow of capital into new firms. It has also led to the creation of "investment clubs," by which small investors can group together to spread investment risks. I have little doubt that enterpise zone investment funds would arise if the mechanism were adopted in the enterprise zone plan here.

As I understand the tax mechanism under consideration by the Administration, the tax package will not stimulate new businesses in the inner cities. Indeed, the program could result in total failure.

If the principal incentives take the form of tax credit, only deductible against income tax liability, they can only be enjoyed by firms paying tax, i.e., not small, start-up firms. This means they will tend to be helpful only to firms that relocate (and it is doubtful that many companies will relocate simply because of the credits) or branches of successful companies. The Administration's tax package would seem to run counter to almost everything we know about location decisions by firms and the nature of small business formation. It is scarcely surprising that small business groups have shown almost no enthusiasm for the enterprise plan as put forward by Administration officials.

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ENTERPRISE ZONES IN BRITAIN: THE EXPERIMENT BEGINS

BACKGROUND

In June 1978, Sir Geoffrey Howe. M.P., chief economic spokesman for the then opposition British Conservative Party, delivered a speech on the subject of inner city revitalization. In the speech, he developed an idea he referred to as the "Enterprise Zone" -- a concept that he saw as a mechanism for breathing new economic life into highly distressed areas of the older cities.[1]

Three years have passed since Sir Geoffrey's speech. During those years the concept of the Enterprise Zone has attracted considerable interest on both sides of the Atlantic. In Britain, a version was passed into law last year, allowing the central government to invite selected cities to submit proposals for sites to be included in an experimental program of less than a dozen Enterprise Zones. Agreement was reached on eleven locations throughout the United Kingdom, and the first of these sites will be formally opened in the summer of 1981.

In the United States, the Enterprise Zone concept quickly became a central issue in the urban policy debate after it was introduced by The Heritage Foundation in 1979. A bill was put before the Congress last year, which would have enabled a form of Enterprise Zone to be created. The bill, The Urban Jobs and Enterprise Zone Act (H.R. 7563, S. 2823), was introduced in the House by Representatives Jack Kemp (R-NY) and Robert Garcia (D-NY),

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[1] For a summary and discussion of the speech and its background, see Stuart Butler, Enterprise Zones: Pioneering in the Inner City (Washington, D.C.: The Heritage Foundation, 1980), and Butler, "Enterprise Zones: A Solution to the Urban Crisis? (International Briefing No. 3, The Heritage Foundation, 1979).

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

and in the Senate by Senators John Chafee (R-RI) and Rudy Boschwitz (R-Minn.). A heavily modified version of this bill (H.R. 3824, S. 1310) was re-introduced, with the same principal co-sponsors, on June 3, 1981.

In addition to congressional interest in the idea, Ronald Reagan emphasized his commitment to the concept during the election campaign, and the Administration has been undertaking an analysis of alternative mechanisms to create Enterprise Zones. Several states and cities have also been examining the concept, and legislation has been introduced in a number of states, such as Illinois and Wisconsin, and in the District of Columbia.

Due to the wide interest in the Enterprise Zone in the United States, the British experiment has been followed by many as a possible guide to the way in which such zones might affect cities in America. Like all such international comparisons, however, we must be wary of too simple an assessment. The British model can provide valuable lessons, but it should be seen in its proper context. It is also important to remember that it is experimental and but one version of the idea.

This paper will analyze the foundations of the British Enterprise Zones, and discuss some of the criticisms and issues that have surrounded the experiment. As the zones have not yet been formally opened, it is impossible to provide any analysis of their track record. Nevertheless, the nature of the legislation, and reactions to it in Britain, provide some perspectives that may be very relevant to the debate in this country.

THE ENTERPRISE ZONE EMERGES

Although Sir Geoffrey Howe outlined the idea of the Enterprise Zone in the summer of 1978, it was not until the spring of 1979 that it began to be treated seriously, and not until March 1980 that a proposal was presented to the House of Commons. A measure was finally enacted in November 1980.

In his 1978 speech, Howe argued that a great deal of the stagnation in the cities was the result of suffocating inaction by government bureaucracy.[2] Although some communities had managed to make progress "in the teeth of institutional inertia," he said, there remained huge tracts of inner city land, often close to centers of high unemployment, which were tied up in red tape. Many of these areas, he maintained, could and should be centers of thriving enterprise, providing much-needed employment, if only the private sector was given a chance to develop them.

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[2] Speech by Sir Geoffrey Howe, June 26, 1978.

Sir Geoffrey pointed out that in many places around the world, such as in Hong Kong and Singapore, the relaxation of regulations, controls and taxes had turned apparently inhospitable locations into booming economic areas. On the other hand, vast public expenditures and grand master plans had produced few results in Britain's inner cities. We should learn something from this, he suggested, and seek to create small, urban test sites, to be known as Enterprise Zones, where the effects of an unshackled market approach could be compared with nearby locations that have been carefully planned and heavily taxed by government.

Sir Geoffrey proposed the establishment of about half-a-dozen such zones in the first instance, each of about a square mile, in urban areas which could be developed quickly. The zones should have the following features:

a) Zoning and building controls would be relaxed. If a proposed development complied with basic anti-pollution, health and safety codes it would be allowed automatically.

b) National and local governments would be required to dispose of any land they owned by auction to private bidders.

c) Significant reductions in taxes affecting new businesses would apply for a guaranteed period. On the other hand, no government grants or subsidies would be available to any entrepreneur within the zone.

d) Various regulations and controls also would be relaxed.

Sir Geoffrey was very concerned that his idea would be frustrated by "grey men" in the bureaucracy at all levels of government -- men whose purpose in life was to emasculate new ideas with fine print. To reduce the possibility of this happening at the local level, he suggested the creation of a new authority specifically for the zones, "to be available as a kind of standard kit for the communities that wished to apply for it." The primary purpose of the authority would be to expedite development and dispose of government-owned property. To ensure that residents of the neighborhood received some benefit from this activity, Howe suggested that they be given an equity stake in the authority, and have the right to require it to buy their land if they did not wish to remain in the zone.

THE BRITISH LEGISLATION

Although Sir Geoffrey Howe's speech did arouse a good deal of interest, it was not until the Conservatives came to power in the spring of 1979 that he was in a position to push the concept towards reality. Almost another year passed before Sir Geoffrey, by then Chancellor of the Exchequer (i.e., Treasury Secretary), announced the government's intention of seeking legislation to allow the creation of approximately six zones, each of about 500 acres.

The strong party system in the British Parliament ensured that the legislation was forthcoming with only minor modifications. There was no "Enterprise Zone Act" as such, but instead the necessary provisions were passed as substantial amendments to two "standard" government bills -- the Finance Act (implementing the annual budget) and the Local Government Planning and Land Act. These measures became law in November 1980.

The major provisions of the Enterprise Zone legislation are as follows:

Designation and Administration of the Zones

The Secretary of State for the Department of the Environment (the department responsible for urban policy) may invite a city to submit proposals for a zone. The right to designate an area as an Enterprise Zone rests with the Secretary, but he cannot do so without the agreement of the local government concerned. Proposals for a zone have to be made public, so that hearings may be held and modifications considered.

Agreement has to be reached between the local government and the Secretary regarding the boundaries and zoning conditions before a designation can be made. When agreement has been reached, the body that was invited to submit the proposal becomes the "Enterprise Zone Authority," charged with the administration of the zone.

The designation lasts for an agreed period, normally ten years, during which time the Secretary of State has no power to terminate the designation. The zoning conditions and the boundary can be modified in the light of experience, but this requires the agreement of both the Secretary and the Enterprise Zone Authority.

Once full agreement has been reached and the designation made, the tax changes specified below come into force.

Tax Changes

a) Development Land Tax

Development Land Tax is the capital gains tax that applies to the element of a land or property sale which is deemed to arise from its potential for development. It is also assessed on the development value of land which the owner himself develops (termed a "deemed disposal"). It is levied at the rate of 60 percent. An effect of the tax is to "lock up" land, since owners have a tendency to avoid selling land for development, or developing it themselves.

Within an Enterprise Zone this tax does not apply, providing that a disposal is make within ten years of the designation of the zone. The aim of this is to speed up the development of zone land.

b) Rates (Property Tax)

In an Enterprise Zone, all business-related buildings are exempt from property tax -- but this concession does not extend to residential buildings or elements of buildings. The local government concerned will be reimbursed by the national Treasury for all lost revenue, on new developments as well as existing buildings.

c) Capital Allowances

Even before the Enterprise Zone legislation, substantial allowances against corporate or personal income taxes existed throughout the United Kingdom for the construction of certain categories of business structures. Allowances of 50 percent of capital expenditures for the construction, extension, or improvement of industrial buildings can be taken in the first year, with an additional writing-down allowance of 4 percent in the first and subsequent years. For hotels, the initial allowance is 20 percent. No such allowance is available for offices, shops, or other commercial buildings.

The Enterprise Zone legislation removes the distinction between categories of development in a zone, and increases the allowance to 100 percent in the first year for all businesses -- including commercial structures. The business may elect to take a smaller allowance in the first year, and write off the remainder of the expenditure at 25 percent per year. If the building is sold within 25 years of the expenditure, however, a clawback mechanism comes into force.

Zoning

Before the central government will agree to designate a site as an Enterprise Zone, the local government must put forward an acceptable proposal to streamline building codes and zoning in the area. These new conditions must be as open and simple as possible, but they must include normal controls over hazardous and polluting developments. All structures must reach the usual safety and health standards.

Providing a proposed development meets these simplified standards, it cannot be blocked. If it does not comply with the standards it may still go ahead, but only if permission is obtained locally in the normal way.

The aim of this provision is to lay down a system of simple guidelines to facilitate rapid and varied development of a zone and to remove much of the arbitrary nature of local zoning and building code requirements.

Simplification of Regulation

Although Sir Geoffrey Howe stressed the easing of controls and regulations in his original speech, there are no significant regulatory changes in the legislation -- other than the zoning modifications. Firms in an Enterprise Zone are relieved of certain obligations to provide government departments with statistical information, and the procedures for obtaining permission to operate warehouses for foreign trade are simplified (but there is no provision for a foreign trade zone).

SUMMARY OF THE MEASURES

The primary aim of the British Enterprise Zones is to encourage the industrial and commercial development of derelict or vacant sites within cities. They are not aimed at populated neighborhoods, nor are they intended to promote mixed use of land -- indeed, the legislation specifically excludes residential properties from the incentives. The government argues that stimulating economic activity within the sites will boost the entire local economy and provide employment for those living nearby.

Virtually all the tax incentives in the Enterprise Zones are linked to the physical redevelopment of the sites (other than the property tax abatement, which does apply to existing structures). A company actually has to undertake construction or improvement before the most significant incentives apply. There is no general reduction of corporate income tax, nor are there any credits or other allowances for hiring labor. The government expressly avoided general business tax reductions in the zones, according to officials, because of the danger that these would give rise to various tax avoidance schemes that would be very beneficial to the companies concerned without contributing very much to development and job creation.

Since generous capital allowances already apply for industrial buildings outside an Enterprise Zone, the tax incentives within the zones are less attractive for these developments than for commercial structures -- which are not given similar allowances outside the zones. In addition, many depressed regions of the United Kingdom are classed as industrial development areas, in which grants are available for new industrial construction. Thus, ironically, the differential between the attractiveness of an Enterprise Zone and nearby areas is smaller, in the case of manufacturing firms, in depressed regions of the country than in relatively thriving regions. The greatest tax incentives of all, on the other hand, apply to commercial and retailing developments. For this category of firm the differential between zones and non-zone areas differs little from region to region.

The capital allowances given in the zones can only be enjoyed by a company which is profitable enough to be paying corporate income tax. The exemption from property tax, however, applies to all companies, and it is most valuable to a company which is lossmaking -- since the elimination of property tax increases profits liable for tax in the case of other companies. Thus, the property tax exemption is most beneficial for a new or marginal company (which will normally have small or zero taxable profits), while the capital allowances are most attractive to branches or relocations by established, profitable concerns.

There is nothing in the legislation, in contrast with the original Howe speech, which requires the disposal of government land within the zones. Furthermore, the Enterprise Zone Authorities are merely other local councils or development agencies wearing a different hat; they are not the kind of "standard kit" Sir Geoffrey alluded to in his original speech, nor do local people have an equity stake in them. In most of the zones chosen so far, a large proportion of the land is owned directly by the national or local government, or by a nationalized industry. So there remains considerable scope for the government to regulate economic development in the Enterprise Zones.

There is no provision for a foreign trade zone in the Enterprise Zone legislation, even though many of the sites chosen are in warehousing or dockland districts. The principal reason for this omission is that, as a member of the European Economic Community, the United Kingdom is bound by treaty obligations which have the effect of restricting special customs arrangements.

POLITICAL REACTION TO THE ZONES

Many Conservatives were disappointed with the Enterprise Zone package. Some argued that the zones were by no means the radical areas which had been promised, where opportunities would be offered to innovative small entrepreneurs. Rather, they claimed, the Enterprise Zones were just another form of special development tax shelter, which would only cause existing jobs and industry to be shifted around for the benefit of a few chosen areas.

The opposition Labour Party was critical of the idea because it felt that the zones would lead to the kind of swashbuckling capitalism that many radical Conservatives doubted. The British Labour Party is not exactly known for its warm feelings towards free enterprise, and so its reactions were not a surprise to most people. Some Labour MPs denounced the idea as a charter for "property sharks, real estate men, lawyers, accountants and tax fiddlers" -- others believed that the area would become a mecca for scrap metal dealers, used car salesmen, sex shops, and other supposed undesirables.

The left-dominated National Executive Council of the Labour Party (NEC) claimed that the concept was merely an insidious plot, designed to reproduce the "horrors" of Hong Kong, Singapore and Chile in Britain's cities (Chile presumably was added in case people did not consider the others sufficiently horrific). The social and democratic environment of such places "where Milton Friedman's theories hold sway" was deemed by the NEC to be "completely unacceptable to a modern democracy."[3]

Despite the bitter denunciations by the NEC and Labour MPs, Labour-controlled local councils almost fell over themselves to submit applications for sites -- much to the chagrin of the NEC and the amusement of Conservatives. Almost all the applicants, and the cities finally chosen, have Labour councils.

For the most part, local politicians and officials ignored the philosophical objections raised at the national level. The general feeling seemed to be that the zones offered the chance of a real shot in the arm for depressed areas and should not be rejected -- even if the idea came from Conservatives.

THE CHOICE OF SITES

The sites finally chosen reflected both economic and political considerations. Northern Ireland was awarded a site in West Belfast; Scotland received one in the depressed shipbuilding area of Clydebank, Glasgow; and Wales a site in Swansea. Five sites were selected in declining northern English cities, including Newcastle, Liverpool and Manchester. Two sites were chosen in depressed parts of the English midlands. Only one zone is located in southern England -- in the Isle of Dogs in London's dockland district.

The average size of the zones is 500 acres, but there is a wide range. The Belfast site, for instance, covers only 200 acres. The Newcastle zone, however, comprises almost 1,200 acres. Virtually all the sites are derelict areas: either expanses of wasteland, or land dominated by vacant, obsolete factory buildings. The Isle of Dogs site even contains several docks within its boundaries. Some sites are strewn with slagheaps and other relics of long-dead heavy industry, and in a number of cases considerable clearance and infrastructure work is necessary before development can take place.

Although the eleven sites were chosen by February 1981, none will be formally opened before this summer. This is because a lengthy process of boundary determination, public hearings, and zoning agreements must be completed before a chosen site can become an Enterprise Zone.

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[3] Enterprise Zones (London: National Executive Committee of the Labour Party, 1980).

LOCAL BUSINESS CRITICISMS

Although public leaders have generally been strong supporters of the Enterprise Zones, considerable anxiety has been expressed by local business interests. Most local businessmen in the cities chosen tend to agree that the zones will bring about significant economic activity: what they fear is that this activity will pose a threat to nearby, non-zone businesses.

To a certain extent this criticism can be dismissed as the age-old opposition of existing businesses to competition. There are many costs and problems associated with the derelict land in the zones -- that is why it is undeveloped -- and the principal tax and zoning changes have the effect of overcoming these start-up costs, rather than providing businesses with a long-term competitive edge.

Local businessmen are more justified in their criticisms regarding the elimination of property taxes in the zones -- since this does constitute a reduction of operating expenses. Local firms have been particularly irritated by the fact that existing firms in the zone are relieved of property tax. In addition, the attractiveness of the zones to retailers (for the reasons detailed earlier) has caused a great deal of concern among downtown retailers, who feel that a strong retailing element in the zones -- which generally are very close to the downtown -- will pull customers away from them and undermine their neighborhoods.

Large retailers have indeed shown great interest in the zones, and several local councils, pressed by business groups, urged the government to agree to a size limitation, at the very least, on retailing establishments in their Enterprise Zones. Although the national government strongly resisted any amendment to the basic idea of an essentially zoneless area, the local objections have effectively been conceded and most of the zone agreements place some restriction on retailing.

The objection to an abatement of property taxes on all business premises stems from the argument that such a blanket provision means that existing firms can obtain a competitive cost advantage without committing themselves to expansion and job creation. While businessmen are often unhappy about an abatement for even new firms, it is conceded that there may be a valid argument for it as an incentive which will generate additional activity.

The government countered these local objections with the argument that compared with the other incentives the property tax exemption will have only a small effect. In addition, officials maintained, a property tax elimination will have more effect on new, small enterprises than on larger ones or branches. The government also claimed that any attempt to distinguish between existing and new firms would be an administrative nightmare: firms might close down and open under a different name if any distinction were attempted. The idea of freezing taxes for the duration of the zone was considered as a compromise, but it was felt that such a move would blunt the incentives.

In the end, the government sought to deal with the problem of existing industry by drawing boundaries in such a way as to exclude as much of it as possible fom the zones. This has resulted in some oddly shaped zones. In a number of cases, the zone has actually become a group of "mini-zones" separated by viable existing businesses.

Despite these concessions, there remains a good deal of skepticism among local business leaders. Until the British zones have been in operation for some time, however, it will not be possible to reach a conclusion on the overall effect on the local economies involved. But despite the well-organized campaigns by local businessmen, there is still generally strong support for the zones among elected representatives, who seem to believe that the total result will be very beneficial.

NATIONAL BUSINESS REACTION

Concern has been expressed by national business groups that the Enterprise Zones will merely have the effect of redistributing jobs and businesses to the advantage of the chosen cities, and will not add to the nation's economy. This belief comes mainly from the feeling that there is little in the Enterprise Zone package to encourage new, small entrepreneurs to enter business, and much to encourage relocation.

The small business sector in Britain is among the weakest in the West. A 1976 study, for instance, showed that West Germany, which has only 10 percent more people than Britain, has 40 percent more firms.[4] Furthermore, there is a dearth of new firms among the small companies that do exist -- the average age of small companies in Britain is three times that in the United States. Yet, the evidence on both sides of the Atlantic indicates clearly that new, small companies are easily the best job generators in the economy, and are the source of the most innovative ideas and processes. In the Enterprise Zones, many argue, little interest has been paid to such firms, and the incentives are more in tune with the concerns of large, existing companies than those of enterprising newcomers.

The government maintains that the zones will be attractive to all innovative businessmen. The property tax elimination will reduce start-up costs for small entrepreneurs, officials say, and the capital allowances will encourage developers to divide up many of the existing large, obsolete factories into small, "incubator" workshops.

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[4] The Economist, June 3, 1980, p. 54.

This optimistic view of the potential of the zones for small firms is not widely shared. The Confederation of British Industry (CBI), representing Britain's larger corporations, has endorsed the broad concept of the Enterprise Zone, chiefly on the grounds that it should provide clear evidence that relaxing controls and regulations leads to economic growth. Yet the CBI sees only:

> limited benefit to smaller firms in the measures. The relief of property taxes, and the simplified planning procedure will be of some assistance, but since most small firms are not owner-occupiers, the exemption from Development Land Tax and the increased capital allowances will have no direct effect.[5]

Representatives of small companies have reached the same conclusion. The Association of Independent Businesses (AIB), for instance, has argued that the incentives for physical redevelopment emphasized in the zones may help property developers, but they are not beneficial to small traders and manufacturers. The AIB points out that most small, new firms lack the taxable profits against which tax allowances can be taken. In addition, the AIB maintains that the property tax relief will not be passed on in the form of lower rents for businesses.[6]

THE BRITISH EXPERIMENT IN PERSPECTIVE

It is too early to evaluate the total impact of the British Enterprise Zone experiment. Disputes over the approach are based on predictions, not evidence. We will have to wait for many months to see whether it is the optimists or the pessimists who are proved correct.

Nevertheless, there are certain conclusions that can be drawn from the experience so far. And in view of the keen interest shown in the idea in America, it is important that the aims and mechanisms of the British model be understood and kept firmly in mind when considering an American version.

a) The British approach is experimental; it is not a general urban program. Furthermore, it is but one version of a broad concept, which aims to encourage economic growth in depressed urban areas by reducing regulation and cost barriers facing entrepreneurs. In addition, the zones are intended to test the effectiveness of a policy of tax and regulatory relief as a basis of general growth policy. But it should be remembered that the British model is not the definitive example of an Enterprise Zone, it is merely the first example.

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[5] CBI Response to the Goverment's Consultative Document on Enterprise Zones (London: CBI, 1980).

[6] Comments on Enterprise Zone Policy Proposals (London: AIB, 1980).

b) The British zones aim to encourage private sector development of largely vacant areas in the cities, as a means of providing jobs and prosperity for the cities concerned. None of the zones is located in a populated neighborhood, nor are there any incentives designed to stimulate the rehabilitation of residential property. Broadly, the zones are not intended to rebuild the roots of a neighborhood economy. This is an important distinction between the British model and the kind of zone being discussed in America.

c) Part of the concern over possible competition with downtown retailing districts is a reflection of two aspects of the British situation which do not hold here. In the first place, the particular attractiveness of the zones to retailers is due to the fact that the sector normally enjoys few development tax allowances compared with other sectors. In addition, crime and serious social problems are less of a concern in British cities than they are in the type of neighborhood usually thought to be ideal for an Enterprise Zone in this country. Retailing is much less likely to be interested in the American zones than is the case in Britain.

d) The British chose a small number of zone sites both because the idea is experimental in nature at this stage, and because the enthusiasm of local government was considered essential. The government felt that it was better to test the concept before any version of it became a central part of urban policy, and a firm of consultants has been selected to monitor the experiment. Since the local government had to agree to zoning changes and the boundary it was felt that strong local support was necessary. The local government also plays a central role in "selling" and managing the zones: once the designation has been made and the tax incentives made available, the national government assumes a passive role in the zones.

e) No precise targetting requirements were laid down as a basis for choosing the sites. After applications had been received, the power of selection rested with the central government. While this might be acceptable for an experimental program, it would probably be unsuitable for a widespread policy. Yet a certain amount of discretion would appear to be necessary, despite the dangers of politicking, if boundaries and local changes are to be established with due regard to local circumstances.

f) Other than the zoning simplification, and the minor changes in national regulations, deregulation is not a major element in the British model -- in contrast with Sir Geoffrey Howe's original speech.

CONCLUSION

The British experiment is less bold in practice that it was in theory. The idea of unleashing small scale capitalists to do the job in the inner cities which government had failed to do gave way to a set of incentives that emphasized major physical redevelopment by larger companies. If the criticisms expressed by some small businessmen prove correct, the British Enterprise Zones may actually hurt small entrepreneurs rather than help them, and relocate jobs rather than create new ones.

We will have to wait some time before the verdict is in, but it does seem that the incentives offered have produced much more excitement among corporate accountants than small entrepreneurs. Unless the latter are mobilized in the cities -- and for that matter throughout the economy -- we will not see much significant growth. And if we are to encourage new, small businesses to be active in an American version of the Enterprise Zone, we must look at measures which will overcome the barriers small firms face: incentives that will stimulate private investment in new companies, and a reduction in suffocating red tape at all levels of government.

Stuart M. Butler, Ph.D.
Policy Analyst

Senator BOSCHWITZ. We are very pleased to have with us this morning Congressman Fowler, who is going to introduce Cornell McBride of Atlanta who is on the next panel.

STATEMENT OF HON. WYCHE FOWLER, JR., A U.S. REPRESENTATIVE FROM THE STATE OF GEORGIA

Representative FOWLER. Mr. Chairman, I thank you for that privilege. While the panel is coming forward, may I overstep the bounds of propriety—since I am a Representative from Atlanta, on the other side of the street, but I represent a major metropolitan area—to commend you on this hearing on free enterprise zones and also to make just two quick, 30-second suggestions, if I may.

Senator BOSCHWITZ. With pleasure.

Representative FOWLER. I have profited by the discussion by Professor Birch and Dr. Butler. As one who used to sit on the back row there in the 89th Congress, working in a staff capacity, in this area I think we ought to look at the model cities program that came up under President Johnson and was enacted in the 89th Congress, and which had some lessons, and lessons to be avoided, I would suggest.

Second, while we have not had this discussion in the House as yet, there seems to be some inconsistency in the move to cut off industrial development bonds, revenue bonds, which seem to me to have the same purpose as the proposal for free enterprise zones. I just thank you for making that observation. You may do with it what you may.

Mr. Chairman, Cornell McBride, on my left, is a very distinguished Atlantan and unique in many aspects, and that is why I asked for this personal pleasure of introducing him. He is a native of Savannah, Ga, on the coast, and the cofounder of M&M Products, which began in Mr. McBride's basement when he was a pharmaceutical student at Mercer University in Macon, Ga. In fact, it began in a 55-gallon steel drum with a pool cue, I think, he and his partner mixing up and making what has turned out to be one of the largest selling hair care products, having begun in 1973 and now with offices in the United States, Canada, Nigeria, and the Caribbean.

Mr. McBride's success speaks for itself but also his community participation as a small businessman has led him to be recognized as one of Atlanta's leading business citizens. Therefore, I thank you for this opportunity. I do not know these other two gentlemen but I am just here on behalf of my constituent and to commend you and your committee for coming up with somebody who has been through the rough spots and made a success of it. I am sure the committee will benefit from his testimony.

Thank you very much.

Senator BOSCHWITZ. We thank you, indeed.

Mr. McBride, you are the first witness. You have been a witness here before, have you not?

Mr. McBRIDE. No, this is the first time.

Senator BOSCHWITZ. It seems to me I have heard of you.

You can either read or summarize your statement. We are running a little slower than we anticipated but you take as much time as you need, since this is important legislation.

STATEMENT OF CORNELL McBRIDE, PRESIDENT, M & M PRODUCTS, ATLANTA, GA.

Mr. McBRIDE. Mr. Chairman, I am Cornell McBride, president of M & M Products Co., Atlanta, Ga. I am here today representing my company, which was established in 1973, and American Health and Beauty Aids Institute, which is a recently formed association of minority businesses that manufacture beauty aid products. These companies which formed the institute represent nearly $150 million in annual gross sales of health and beauty aid products to the black community and provide more than $25 million in annual salaries to 1,500 black employees. I have attached some material concerning the institute for your information.

The institute, which I serve as first vice-chairman, views the successful passage of enterprise zone legislation with its potential benefits for economically distressed areas as a primary area of interest for its Government relations program. I trust the following comments will be helpful to the committee in its consideration of the enterprise zone concept.

First, I would like to commend the committee for holding these hearings. We are into the second year of this administration's term and yet no specific proposal detailing the administration's recommendation for implementing the enterprise zone concept has been finalized. Also, the Congress has not moved beyond the hearing stages of any of the various legislative proposals that have been produced.

This is particularly disturbing since the enterprise zone concept was originally intended to be a major component of the Reagan administration economic revitalization program. Perhaps your hearing will serve as a catalyst to move this concept from the discussion phase to providing real benefits and assistance for the economically distressed areas of the country.

I am interested in the enterprise zone concept because of M & M Products' current situation. I have manufacturing, wholesale, and office facilities scattered in six different locations on the outskirts of Atlanta. My total employment is approximately 430 people, predominantly black. I am exploring the feasibility of consolidating my business activities into a single location.

Relocating in a designated enterprise zone area in Atlanta, assuming there is one, is obviously something I would consider. That consideration would be based not only on a business perspective but also my personal view that minority business should do whatever it can to assist the communities they serve by providing jobs and keeping the dollars and other benefits circulating in the community. Too often people come into distressed areas, black and white, and "take the money and run." Perhaps the enterprise zone concept can help redirect that trend.

As I understand it, the enterprise zones will encompass areas of severe economic distress, both urban and rural. That usually, although not always, means areas of high unemployment containing residents with low educational levels and few occupational skills. Further, outdated or inadequate public services such as water and sewer facilities, higher crime rates, and poor police and fire protection are characteristic of such areas, particularly in urban settings. This also means a high concentration of minorities in urban areas.

Tax incentives will not address these problems and they cannot be remedied by businesses, particularly small businesses, moving into enterprise zones. It is in fact those kinds of services that must be provided by local governments in order to attract economic activity into an area in the first place. Without adequate public services, businesses simply will not locate in distressed areas.

In addition to job training and manpower programs, recreational benefits, adequate housing, and other amenities are essential in order to attract companies to deteriorated areas. Also, adequate police and fire protection will have a direct impact on liability insurance for companies locating in these areas, and it is critically important that such protection be provided.

I am also concerned about adequate transportation of supplies and products in and out of the enterprise zone areas. Often these locations are not situated near transportation routes and could be a hindrance in a company's decision to locate in an enterprise zone area.

Tax credits for disadvantaged workers, elimination of capital gains taxes, reduction in corporate income tax rates are obviously beneficial to businesses. Certainly such benefits would encourage business already located in enterprise zone areas to remain in a location or expand their activities.

The institute strongly recommends that such incentives be applied to existing businesses in those areas. However, special tax credits would not provide the capital needed for businesses to construct facilities in enterprise zone areas, any more than tax credits provide the necessary infrastructure and police and fire protection.

In that regard, local development corporations—LDC's—through the availability of bonding authority and other means, will have to assist with capital formation. Also, traditional forms of assistance such as the Small Business Administration programs, the Economic Development Administration and HUD's economic action grant programs, must be available not only to assist businesses with capital formation but also to help local governments to build the necessary infrastructure. Unfortunately, that type of assistance is either being drastically reduced or cut back altogether.

Finally, Mr. Chairman, I would like to stress the absolute necessity of assisting those businesses already located in enterprise zone areas and also those which employ large numbers of residents from those areas. For example, I would encourage you to consider some type of tax credit for firms hiring unemployed or disadvantaged residents from enterprise zone areas, even if those firms are not located in the zone.

Given the lack of available capital for construction, this would be an excellent vehicle to encourge the hiring of residents from disadvantaged areas. Certainly such tax assistance would help an employer offset the cost involved in training these workers or providing other needs such as transportation.

If this Congress can produce legislation that attacks the problems facing distressed areas through the use of a variety of tools, then perhaps business—working in cooperation with Federal, State, and local governments—can make a difference. Tax incentives alone will simply not do the job.

On behalf of the American Health and Beauty Aids Institute and M & M Products Co., I thank you for this opportunity to present our views. We will be happy to answer any questions.

Senator BOSCHWITZ. We thank you, Mr. McBride.

The bill that we fashioned does indeed include businesses that are already in the zones. It even includes people who want to improve or renovate housing.

I want to point out one of the reasons—just for the sake of our ongoing witnesses here, that we do not go over the same material again, though it is valuable to hear about transportation needs and so forth—one of the reasons that I feel very strongly that 25 is the upper limit of how many zones we should establish is that we want to have a very active and very spirited bidding take place between the various communities. They have to come up with advantages with respect to real estate taxes, building codes, fire protection, police protection, and transportation facilities.

They should not and I do not think will be chosen unless they do, because there are such a limited number of enterprise zones established. One of the purposes of limiting the number is to try to make the whole thing work by making the bidding process competitive. Therefore, we believe that these public services are going to be taken care of. As a matter of fact, there is a great deal of leverage that can be given to incoming businesses.

Again, we will speak about that on the floor for the purpose of expressing our feelings—and you help develop those feelings, all of you, for which we are appreciative—of what is to be achieved by this legislation and what local communities are expected to do if they are going to have favorable treatment on their bids.

Our next witness is Mr. William Lytle of Waterbury Pen Corp. in Bridgeport, Conn. That is a very old name indeed.

Mr. **Lytle**. Well, Mr. Chairman, we like that confusion but you are thinking of the Waterman Pen Co. We like to promote that confusion. It helps our sales. [Laughter.]

Senator **Boschwitz**. I might tell you that my company, the same thing happened. A number of people used names close to ours and I always thought that was a compliment.

Mr. **Lytle**. It makes up for having your mail sent to Waterbury when you are located in Bridgeport. [Laughter.]

Senator **Boschwitz**. Well, we look forward to your testimony, Mr. Lytle.

STATEMENT OF WILLIAM F. LYTLE, PRESIDENT, WATERBURY PEN CORP., BRIDGEPORT, CONN.

Mr. **Lytle**. Mr. Chairman, I want to first of all start off by saying I thank you very much, you and the members of the committee, for inviting me to provide testimony. I have prepared a written statement on my views and I would like to read it, if you will bear with me, because I think there are some comments in this statement that are worthy of note, particularly in light of the testimony that was provided by the previous panel.

Senator **Boschwitz**. Are you going to read all 11 pages, Mr. Lytle?

Mr. **Lytle**. Well, I can get to the recommendations, perhaps, and then back them up with my thoughts in the body. That might be a little easier for us if you think that might be too long. Let me try that and——

Senator **Boschwitz**. Well, move along as fast as you reasonably can.

Mr. **Lytle**. I will.

Senator **Boschwitz**. We understand that witnesses come quite a distance and then we do not want to impose unreasonable limitations of time.

Mr. **Lytle**. My comments regarding this new and welcomed legislation are directed at the problems of business development in urban areas and the programs the Federal Government can undertake to resolve them. These comments are derived from my experiences in developing and managing small business operations of less than 100 employees in distressed urban communities, communities that I am sure would qualify as enterprise zones under this new legislative proposal.

I have been involved with small business development in these communities for the past 14 years, the first 4 as a small business consultant involved in the development of minority-owned businesses, and the last 10 as owner and manager of two small businesses, both located in depressed urban communities. These experiences do not necessarily make me an expert on business development in economically depressed areas but they certainly have provided me with a perspective on the problems associated with operating them.

As I understand it, the principal objective of this proposal is to create the necessary incentives for business to locate within or expand their existing operations in distressed urban communities. The benefits of this business development would be to create jobs that provide immediate income for zone residents and provide them with skills that will enable them to take advantage of other employment opportunities outside of the zone areas; to increase investment in these areas that, in addition to providing for productive work activities, will improve the physical appearance of the community; and to reduce Government-financed family assistance programs that provide support for some of the zone residents.

In discussing the problems of operating businesses in these areas, I found it easiest to group them into general topics that comprise some of the basic functions of a business. Recommendations that may be appropriate for inclusion in pending legislation follow the general overview of problems.

In any business enterprise, it is the management that defines the direction for the business and brings to it whatever resources are necessary to enable it to conduct its operations properly. It is the capability of that mangement that most influences the potential success or failure of the business enterprise.

In developing businesses in economically depressed urban areas, the business manager has the additional task of dealing with the problems of personnel development and crime associated with operating in these locations. These additional burdens have discouraged many white business managers from establishing and expanding their business operations in these areas. The development of minority-owned businesses managed by minority residents of the area or those who could operate businesses in the area has proceeded very slowly.

The attempts to develop businesses owned by the residents in depressed urban areas have not always been undertaken by those people with the necessary business management skills that would enable them to make their business successful. The majority of the people who reside in these areas have had very little opportunity to be exposed to business management. Many times the extent of their management experience is the supervision of their fellow direct labor employees.

Most minority managers that have developed the skills necessary to operate a small business have developed them inside of some other business enterprise. Once achieving these skills and the rewards that go with them, they are reluctant to leave these places of employment to venture out on their own and undertake the development of small businesses. Substantial inducement must be provided to encourage these people to leave their hard-won positions of management to undertake development of a business. These inducements could also encourage white entrepreneurs to look more favorably on depressed urban areas to establish and expand their enterprises.

The small businessman has to operate in many different areas of his business in order to make sure it functions properly. Since his operation is not large enough to employ a number of specialists in each of the basic disciplines of his business, he must be functional in general management, sales, finance, operations, personnel, and purchasing. As he does not have time to function in all of these areas effectively, he typically gravitates to those areas he enjoys or that have obvious problems, and provides very little time for other functions.

Usually one of the key areas that is often overlooked is the area of financial management and cost control. Small businessmen often rely exclusively on their accountants to provide them with information on the financial status of their business. The small business manager often does not comprehend the financial statement provide him and, of course, once this information has been developed it is past history, and may be provided too late to correct the problems that the financial statement revealed.

As the business begins to grow and requires experienced supervisors or managers to control specific functions of the operation, often new management problems occur. Many times these managers have to be recruited from outside the area. Many experienced managers do not want to work in economically depressed areas. In the case of minority-owned businesses, recruitment of white managerial help is an additional problem. New managerial candidates are not only reluctant to come to the area but are skeptical about working for a minority-owned firm.

The problems of marketing are not problems unique to businesses located in economically depressed areas but are general problems of all small businesses. The ability to clearly identify a market for the firm's goods and services and to develop the capability to reach that market to see the firm's goods or services, is a key ingredient to the development and expansion of any business operation.

Too often small business people do not have access to the major purchasers of their goods and services, or do not have the resources necessary to extend themselves to some of these major purchasers. A clearly identified and accessible market for the firm's products, along with managerial skills, are the most critical factors in the firm's ability to develop and expand.

Firms that have minority ownership have a particular problem in marketing their products. Potential purchasers do not have the confidence that the minority firms have the ability to provide these goods and services. This credibility problem can often be overcome by establishing a good business relationship with a generally recognized major firm. This relationship will give the marketplace the assurance that the small business can perform up to certain standards and is therefore no longer a risk to other potential purchasers to consider its products and services.

Most small businesses do not have sufficient financial resources to properly advertise or promote their business. Since it is very difficult to measure benefits derived from these activities, small businessmen tend to concentrate more on personal contacts to perform this function. Small businessmen also have problems in breaking into the normal channels of distribution.

Often, consumer products are sold on the basis of brand recognition created by the competitor's longtime existence in the marketplace or by their advertising. The typical vehicles used for gaining access to the distribution system for a small business is based on a lower cost product or by providing a special service that is not available from its competitors.

The task of obtaining money at a reasonable cost to begin and develop a business is a problem for all business managers. The problem becomes more acute when the business is located in an economically depressed area. Banks are reluctant to provide loans to small businessmen located there. They typically look upon these firms as very high-risk business enterprises.

There is also very little venture capital available to a small business person to supplement any bank loans they can obtain. If venture capital is available, it is usually provided as additional debt.

The Small Business Administration has loan programs to support the development of small businesses. They also have special programs geared toward the development of minority-owned small businesses. Most of these programs, however, have featured debt as a prime vehicle for financing small business operations.

This debt adds substantially to the firm's cost of doing business and oftentimes drains too much of the working capital that is needed for development and expansion. Typically the debt is structured to be paid back over a relatively short period of time with principal payments to be made almost immediatly upon the disbursement of the loan. Small businessmen often find themselves pledging all of their personal assets as security to obtain loans for their business operations. This requirement remains long after the business has accumulated sufficient net worth to more than provide the security necessary for the loan.

Because there are very few venture capital firms who will provide equity money, small business persons are limited to their own resources and the resources of their family and friends for seed capital that they need to start their business. Too often, the businesses are started with a substantialy higher debt component in the capital structure——

Senator **Boschwitz**. Did you have an aunt?

Mr. **Lytle**. Did I have what?

Senator **Boschwitz**. An aunt who——

Mr. **Lytle**. Yes, I had an aunt and a mother-in-law and a few other people who provided me some venture capital.

This debt is typically allocated to meet immediate operational needs of the business. In addition to placing a substantial burden on its working capital—I am not sure but I think I skipped a sentence—in addition to placing a substantial burden on its working capital, a business that is heavily debt financed cannot adequately respond to changes in marketing conditions that require it to develop new capabilities.

Senator, at this point I have to agree with you. This is a long statement and I will go right to the recommendation portion of it in the interest of time. I did want to start off by reading it because I thought that the background provided in the beginning sections would give more understanding for people when they heard the recommendations but I will go right to them. I would like to have my prepared statement in its entirety included as part of the record of my testimony. Based upon the functional explanations that I was going through, I have taken recommendations in that order.

Management assistance to support small business people is necessary to enable them to comfortably control the many functional areas of their business. Resource people need to be available to help new entrepreneurs develop skills in areas where they have not been previously trained.

This management assistance could be provided by special consulting firms contracted by the Federal Government, who have an appreciation for the problems associated with operating a small business or by personnel of the major corporations with whom the firm does business. If the personnel of a major corporation are used in this manner, the value of assistance they provide can be added to the price bonus discussed in recommendation three.

Recommendation No. 2—and these are recommendations that I am suggesting might be added to the legislation, Senator—the Federal Government purchases goods and services of every type and description. Firms located in enterprise zones, employing enterprise zone residents, could be given special consideration for contracts to provide these goods and services. These contracts could be awarded on a set-aside basis to qualifying enterprise zone firms.

What I am looking at here and with two other recommendations is to create a market so that firms will have a market to start their operations, and this market will be targeted for enterprise zone firms and their creation.

Recommendation No. 3: Prime contractors to the Federal Government purchase goods and services to support their operations, and also have subcontract work to be performed. They could be induced via price adjustment bonuses to purchase goods or services or subcontract items from firms located in enterprise zones. These price bonuses could be increases in the moneys they would receive from Government contracts and would be based upon the dollar amounts of goods and services and subcontract items they purchase from enterprise zone firms.

Recommendation No. 4: Reductions in Federal taxes could be provided to any business who purchases goods or services from firms located within enterprise zones. These tax reductions would be based upon the dollar amounts of purchases the business makes from enterprise zone firms.

Recommendation No. 5: Long-term, low-interest loans could be provided by the Government, to be a low-cost source of money to help finance new business activities. These loans could include warrants for the purchase of stock in the more successful companies. The warrants could be sold back to the company or to other interested investors. This debt could be structured such that the principal payments are lighter in the early years of the loan to enable the company to retain cash for development and expansion.

Recommendation No. 6: Reduced income tax for businesses located in enterprise zones.

Recommendation No. 7: Equity investment stimulation; I was glad to hear the gentleman on the previous panel make this recommendation. The Federal Government could provide tax incentives for individuals or corporations who make investments in enterprise zone companies. Reductions in personal or corporate income tax at the time of the investment, and reduced capital gains tax at the time of the sale, could induce investment.

Recommendation No. 8: Capital development for enterprise zone companies doing business directly with the Federal Government. Funds to purchase production equipment that can make the firm's cost lower during the conduct of contracts could be provided. Cost improvements derived from new equipment would enable the company to reduce its prices for the products it is producing under the contract, and will enable price reductions to be made on all future contracts.

Recommendation No. 9: Government surplus equipment. The Government has a substantial amount of equipment that it has provided to prime contractors which is surplus to the contractors and to the Government. This surplus equipment is either located in Government-owned facilities or the prime contractor's place of business. Some of this equipment could be utilized by enterprise zone companies to conduct their operations and thereby lower their overall cost of doing business. This would also reduce the capital required to finance their operations.

Recommendation No. 10: Advance or progress payments for enterprise zone companies doing business directly with the Federal Government. These payments would enable the firm to cover the early costs of contracts without having to borrow additional working capital that could add to the company's cost of doing business.

Recommendation No. 11: This is tied into the suggestion that we point out to you programs that the Federal Government has that might help the development of enterprise zone companies. The WIN program has been an excellent program developed by the Federal Government to encourage employers to provide jobs to people who are receiving AFDC. This program provides Federal tax credits for companies who employ welfare recipients. In addition, training moneys are provided by the States to supplement the company's initial cost of hiring and training.

Due to Federal budget cutbacks, this training component has been eliminated and there is some question as to how long the WIN program will be supported by Federal and State Governments. If economic development is to occur in economically depressed areas, programs like this must be increased rather than reduced. This program has been a cost-effective program for the Government and has saved the Government more money than it has expended for its support. In addition to providing incentives for companies to hire welfare recipients, this program has an impact on the overall family structure by changing the attitudes of newly employed welfare recipients and their children.

The last item is education, recommendation No. 12. Let me read it. Although this recommendation does not fall directly within the domain of the Senate Small Business Committee's activities, it has a direct bearing on the issues being discussed. Standards need to be developed for the educational systems throughout the country to insure that children receive a good foundation in the basic educational fundamentals for reading, writing, and basic math.

This is particularly crucial to people who reside in and are educated by the public schools in economically depressed areas. Without these basic skills, children educated in these systems are handicapped when entering the job market and are all but eliminated from attaining opportunities for higher skilled, higher paying jobs. Performance levels should be established at each grade of the educational system to insure that children who pass through that system are developing along predictable paths, paths that will yield them sufficient education to develop special working skills.

Without this renewed emphasis on basic, fundamental skills in the educational process, people who pass through this system will have little or no chance to change their economic status. This is even more crucial as we look into the future and see more and more of the jobs that will be developed are technical in nature and will require better basic educational skills.

I point this out because so many of the people who come to apply for jobs in firms that are located in economically depressed areas—and that is where my firm is located—have deficiencies in their educational background. If I had time to read the rest of my statement, we have a difficult time in being able to develop these people and particularly promote them to supervisory responsibilities. It is not because they cannot learn; it is because their basic educational background is so weak that they cannot function as administrators. I think this is the underlying problem of why enterprise zone type of areas exist, that our basic, fundamental educational system is not equipping people to go on and develop other skills.

That is the end of my statement, Senator. I thank you for bearing with me on the time.

Senator BOSCHWITZ. Let me comment on your testimony, Mr. Lytle. You have very obviously thought through very carefully and have made a series of suggestions, some of which, as you indicate, would be difficult for this committee to implement, particularly your last suggestion. However, some of them I find to be very useful and as we develop the bill further we will use them.

I have a great sense of the beginning of your statement, inasmuch as I also started a business from ground zero and encountered some of the same difficulties. There is no question in my mind that if I were black, it would have been more difficult for me to begin my business, more difficult for me to deal with banks and other things. However, I relate very well to your statement and I will read the balance of it later. Be assured that it is going to have a place not only in our record but in our thinking.

Senator, do you have any questions of the witnesses up to this point? Otherwise, I think we will take a short recess. We have a vote on the floor. Senator Hayakawa has left me with a question as well, and I will ask that when I come back. Unless you have some questions, Senator Tsongas, we will take a break and we will go over and vote, and then reconvene.

Senator TSONGAS. Mr. Chairman, I have a conflict at 11:30 but I am very interested in this issue and will read the statements very carefully, and appreciate their coming.

[Recess taken.]

Senator BOSCHWITZ. We expect a series of votes at very short intervals during the course of the day, so that we are going to proceed again and ask all witnesses to summarize, particularly in those areas where witnesses before them have spoken at some length.

In the event that you, Mr. McBride, have to leave to catch a plane, I do not believe that we will have further questions of you. If you want to stay, you are certainly welcome to do that.

Mr. Carey, we are ready to receive your testimony.

STATEMENT OF G. CHESTON CAREY, JR., PRESIDENT, CAREY MACHINERY & SUPPLY CO., INC., BALTIMORE, MD.

Mr. **Carey**. Thank you, Mr. Chairman. My name is Cheston Carey, and I am president of the Carey Machinery & Supply Co., the distributor of industrial supplies and machinery in Baltimore since at least 1887.

Senator **Boschwitz**. You founded the company, did you?

Mr. **Carey**. Yes.

Having come the shortest distance, I think it is only appropriate that I make my remarks as short as possible, and I will. I have been trying to edit them as the testimony has gone forward.

I do think it is important to note that I testify with several hats on. One is as a small businessman; second, as a wholesaler/distributor with some 45,000 of us in this country who have a real interest in this legislation, both from the point of view of what it might do for the inner cities where many of us are located and, second, as possibly opportunity for a few of us for our kinds of businesses.

Third, I have spent some amount of time on the Greater Baltimore Committee studying this legislation and the literature on it. Finally, I come as an unabashed Baltimore booster to remind the Senate that we have in being an enterprise zone in Baltimore called Park Circle which is waiting to compete—and I approve of the idea of competition—to receive a designation as a Federal enterprise zone.

Let me say at the outset, I do not believe that small business, with the exception of minority-owned and run businesses, will be attracted to the enterprise zones for any of the social or political considerations that are beginning to motivate some of our larger businesses. Therefore, the enterprise zone legislation and implementation, as has been said over and over again today, must provide measurable and early benefits to the small businessman that clearly outweigh the locational drawbacks.

Let me hasten to say, however, that I firmly believe that the tax incentive package that has been mentioned and is a key point of most legislation that has been considered should remain as an incentive to attract the medium- and large-size businesses to such zones. Too much of the talk about this legislation has focused on small business alone, implying for one reason or another that the bigger ones would not help and hence should not be lured. I say this is nonsense. As a small businessman, I would be delighted to see Control Data, C&P Telephone Co., and Commercial Credit as my neighbors. This happens to be what has already happened in Baltimore in our prepackaged enterprise zone at Park Circle.

Back to small business: first and foremost, easily available, inexpensive seed capital. This has been said over and over again and I simply want to repeat it for emphasis. It is not easy to come by. I have had experience with SBA and minority loans, and it makes good press but when you get down to raising the money and getting through the tortuous path of the SBA and things like that, it is not that easily available and often runs out. Venture capital, it has been said, is not going to supply it. The banks are terribly nervous about the kinds of businesses that are trying to come into enterprise zones.

I do not have any ready answers, although from my limited experience in this area I would suggest that the leveraging of local capital provided by private sources, through such mechanisms as SBIC's that have already been tried, might be something that the Congress should consider.

Once having addressed this problem of seed capital, the legislation was next focused on reducing operating expenses. We have already heard, and I agree that inner-city businesses that might consider relocating are probably marginal and hardly looking for salvation through sheltered capital gains. What might excite them, however would be concessions that could immediately improve their profit margins or in the case of new businesses, minimize their losses over the first couple of years.

I agree with you, Senator, that we are not looking for businesses that are going to last 7 or 8 years in the unprofitable area. I would think it is closer to a 2- or 3-year period and that we really should not be financing businesses that are going to be in there losing money that long.

I believe the legislation should not try to tackle the question of a lowered minimum wage. I think it is too impractical to bog this legislation down with so I would not have a position on that.

Senator BOSCHWITZ. I agree with that. I think we would get terribly bogged down and——

Mr. CAREY. Incidentally, one of the smaller businesses in Park Circle is paying minimum wage and is in a lot of trouble with the community for paying the minimum existing Federal wage. Even that is an issue, so you can imagine what the impact on the community would be with a lowered minimum wage.

Third, I think that small business needs outside support in significant quantities to make the equation appear favorable. A lot of us have heard the story about Control Data, where they put a plant in I believe it was downtown Minneapolis, and they found that particularly on Mondays they had a very reduced work force. They found out that a lot of them were in jail, so they send the corporate counsel down there to get them out and they turn their human resource division loose on them and give them counseling.

Small business cannot afford these kinds of luxuries so we have to provide these kinds of help for them in the enterprise zones. These include such things as counseling on how to hold a job, how to apply for and hold a job; all the problems of drug and alcohol abuse; some of the business services like lawyers and accountants and the like.

Finally, something I learned just the day before yesterday in talking to our enterprise zone people, outreach to the community, there has to be an understanding by the community that is to be impacted by the enterprise zone as to what it is trying to accomplish. Without their support, they can make it even more difficult than it already is.

Lest this sound like a rehashed version of big spending programs of the past, cloaked in free enterprise language, let me add several suggestions. First, we believe that the enterprise zone should be considered an experiment, as has been discussed before. I would come down on the low end of the range of perhaps 10 in any one year, insuring that what funding could be afforded would be adequate and, adding to what I prepared as testimony, that the downstream measurements—as has been suggested here—can truly be done on a qualitative basis rather than a quantitative basis.

I served as chairman of the Council for Equal Business Opportunity for 7 years and I got so tired of seeing the computer-generated reports which had to come to Washington to justify our existence and additional funding, when I knew that we were dealing in quantities and not quality, that I felt very guilty about the moneys that were coming back. I think that it has been said before but I would like to stress it, that the qualitative measurement of what we do accomplish in these enterprise zones should very definitely be part of the legislation.

Senator Boschwitz. I think that early on there will perhaps not be 25. I know the mayor of a major city wanted 400 a year. I said that then they would become like every industrial park that every little town has and would become meaningless. Therefore, I quite agree.

Mr. Carey. Second, there should be some upper limits to the dollar amounts of refunds, credits, relief, and support services that could be furnished to any one company, as well as a time limit on its eligibility for any benefits other than tax relief. We should not, as I said earlier, allow losers to stay losers in these enterprise zones too long.

Third—and I think this might be an original suggestion—the companies that come to the zones might be allowed to choose among a variety of benefits and services up to a certain total dollar value per year, per employee, in cafeteria style. This is analogous to the concepts currently coming into vogue in personnel benefit programs where the individual chooses what is best for him within limits established by the company.

As many small businesses as you get to testify here, you will probably get as many different ideas of what they need and what their highest priorities are. Rather than try to guess in legislation, let's give them a chance; let's give some flexibility and let them choose.

Finally, small business is going to stay away in droves if you end up with complex legislation loaded with safeguards for public dollars. The only ones who will bother to apply will be those who already can afford high-priced lawyers and management consultants. Very simply my message is, take a chance and keep it simple.

Throughout my testimony I have stressed the need for many services to be provided outside the tax abatement, tax credit areas. I am aware that the enterprise zone legislation can go nowhere loaded with all sorts of new funding initiatives. Therefore, it seems to me imperative that existing programs such as UDAG, EDA, CETA, and IRB funding be kept in place. We do not view the enterprise zone—and you do not either, Senator—as an urban policy by itself, but simply another tool to be used by the cities to continue the war on decay and the sad condition of the unemployed and the disadvantaged.

We have many statistics to prove how effective these other programs have been in Baltimore in revitalizing distressed areas. Rather than trying to recite them, let me suggest you could much better understand them by taking a trip to Baltimore.

In conclusion, I would stress once again that the package of rewards that must be made available to small businesses to convince them to try enterprise zones must be a lot broader and deeper and more immediate than currently suggested tax credits and regulatory relief. The need is great to make it happen but the obstacles to succeed are imposing. I am convinced, however, it is worth doing right on a small scale the first time in hopes that we can find another urban initiative in which investment of tax dollars can truly be justified.

Mr. Chairman, I have foreshortened my testimony a great deal and would request that the written testimony I have submitted and the attachments be made part of the record, if that is in order.

Senator Boschwitz. It will be done.

I appreciate your testimony. I share your viewpoint A lot of my effort with respect to this bill has been what you talk about: Reduce operating expenses benefits. Too many of the benefits that we give, you have to make a profit to get. My experience is that if you need to reduce one of the expenses that I am going to have to pay whether it be real estate taxes, cost of interest, or rent, will reduce expenses. Otherwise you never get to the bottom line.

I really will keep pounding away at that. I find your testimony very helpful, and I thank you very much for coming, Mr. Carey.

Mr. Carey. Thank you.

Senator Boschwitz. Thank you also, Mr. Lytle.

[Material follows:]

STATEMENT BY
CORNELL MCBRIDE, PRESIDENT, M & M PRODUCTS
3602 BROWNS MILL ROAD
ATLANTA, GEORGIA
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
FEBRUARY 25, 1982

MR. CHAIRMAN, I AM CORNELL MCBRIDE, PRESIDENT OF M & M PRODUCTS, ATLANTA, GEORGIA. I AM HERE TODAY REPRESENTING MY COMPANY WHICH WAS ESTABLISHED IN 1973 AND THE AMERICAN HEALTH AND BEAUTY AIDS INSTITUTE WHICH IS A RECENTLY FORMED ASSOCIATION OF MINORITY BUSINESSES THAT MANUFACTURE HEALTH AND BEAUTY AID PRODUCTS. THE COMPANIES WHICH FORMED THE INSTITUTE REPRESENT NEARLY $150 MILLION IN ANNUAL GROSS SALES OF HEALTH AND BEAUTY AIDS PRODUCTS TO THE BLACK COMMUNITY AND PROVIDE MORE THAN 25 MILLION IN ANNUAL SALARIES TO 1,500 BLACK EMPLOYEES. I HAVE ATTACHED SOME MATERIAL CONCERNING THE INSTITUTE FOR YOUR INFORMATION.

THE INSTITUTE, WHICH I SERVE AS FIRST VICE-CHAIRMAN, VIEWS THE SUCCESSFUL PASSAGE OF ENTERPRISE ZONE LEGISLATION WITH ITS POTENTIAL BENEFITS FOR ECONOMICALLY DISTRESSED AREAS AS A PRIMARY AREA OF INTEREST FOR ITS GOVERNMENT RELATIONS PROGRAM. I TRUST THE FOLLOWING COMMENTS WILL BE HELPFUL TO THE COMMITTEE IN ITS CONSIDERATION OF THE ENTERPRISE ZONE CONCEPT.

FIRST, I WOULD LIKE TO COMMEND THE COMMITTEE FOR HOLDING THESE HEARINGS. WE ARE INTO THE SECOND YEAR OF THIS ADMINISTRATION'S TERM AND YET NO SPECIFIC PROPOSAL DETAILING THE ADMINISTRATION'S RECOMMENDATION FOR IMPLEMENTING THE ENTERPRISE ZONE CONCEPT HAS BEEN FINALIZED. ALSO, THE CONGRESS HAS NOT MOVED BEYOND THE HEARING STAGE ON ANY OF THE VARIOUS LEGISLATIVE PROPOSALS THAT HAVE

BEEN PRODUCED.

THIS IS PARTICULARLY DISTURBING SINCE THE ENTERPRISE ZONE CONCEPT WAS ORIGINALLY INTENDED TO BE A MAJOR COMPONENT OF THE REAGAN ADMINISTRATION'S ECONOMIC REVITALIZATION PROGRAM. PERHAPS YOUR HEARINGS WILL SERVE AS A CATALYST TO MOVE THIS CONCEPT FROM THE DISCUSSION PHASE TO PROVIDING REAL BENEFITS AND ASSISTANCE FOR THE ECONOMICALLY DISTRESSED AREAS OF THIS COUNTRY.

IT IS MY UNDERSTANDING THAT THE COMMITTEE IS INTERESTED IN WHETHER OR NOT TAX INCENTIVES AS A PRIMARY TOOL WILL PROVIDE THE STIMULATION NEEDED TO ATTRACT BUSINESSES PARTICULARLY SMALL BUSINESSES TO DESIGNATED ENTERPRISE ZONE AREAS OR EXPAND BUSINESS ALREADY LOCATED IN THOSE AREAS. REALIZING THAT THE MAJOR BENEFITS OFFERED BY THE EXISTING ENTERPRISE ZONE PROPOSALS ARE VARIOUS TAX INCENTIVES THE COMMITTEE'S CONCERN IS MOST APPROPRIATE.

I AM PERSONALLY INTERESTED IN THE ENTERPRISE ZONE CONCEPT BECAUSE OF M & M PRODUCTS CURRENT SITUATION. I HAVE MANUFACTURING, WHOLESALE AND OFFICE FACILITIES SCATTERED IN SIX DIFFERENT LOCATIONS ON THE OUTSKIRTS OF ATLANTA. MY TOTAL EXPLOYMENT IS APPROXIMATELY 430 PEOPLE, PREDOMINANTLY BLACK, I AM EXPLORING THE FEASIBILITY OF CONSOLIDATING MY BUSINESS ACTIVITIES INTO A SINGLE LOCATION. RELOCATING IN A DESIGNATED ENTERPRISE ZONE AREA IN ATLANTA (ASSUMING THERE IS ONE) IS OBVIOUSLY SOMETHING I WOULD CONSIDER. THAT CONSIDERATION WOULD BE BASED NOT ONLY ON A BUSINESS PERSPECTIVE BUT ALSO MY PERSONAL VIEW THAT MINORITY BUSINESS SHOULD DO WHATEVER IT CAN TO ASSIST THE COMMUNITIES THEY SERVE BY PROVIDING JOBS AND BY KEEPING THE DOLLARS AND OTHER BENEFITS CIRCULATING IN THE COMMUNITY. TOO OFTEN PEOPLE COME INTO DISTRESSED AREAS, BLACK AND WHITE, AND "TAKE THE MONEY AND RUN." PERHAPS THE ENTERPRISE ZONE CONCEPT CAN HELP REDIRECT THAT TREND.

HOWEVER, IT IS MY OPINION THAT TAX INCENTIVES WILL NOT BE SUFFICIENT TO ATTRACT ME OR OTHER BUSINESS TO ENTERPRISE ZONE AREAS. SPECIAL TAX INCENTIVES MUST BE AVAILABLE IN CONCERT WITH OTHER TOOLS, WHICH I WILL DISCUSS. BUT, ACTING ALONE, TAX RELIEF WILL NOT MEET THE OBJECTIVE OF REVITALIZING DISTRESSED AREA. I WOULD ALSO SUGGEST THAT ANY FEDERAL TAX BENEFITS MUST BE SUPPORTED BY STATE AND LOCAL TAX INCENTIVES IN THE FORM OF PROPERTY TAX REDUCTIONS AND RELIEF FROM OTHER LOCAL REVENUE ENHANCING PROGRAMS. IF STATE AND LOCAL GOVERNMENTS ARE TO PLAY A ROLE IN DESIGNATING AND MANAGING ENTERPRISE ZONE AREAS, AS CALLED FOR IN MOST OF THE PROPOSED LEGISLATION, THEY SHOULD ALSO BE EXPECTED TO PROVIDE INCENTIVES INCLUDING, BUT NOT LIMITED TO, TAX BENEFITS.

AS I UNDERSTAND IT, ENTERPRISE ZONES WILL ENCOMPASS AREAS OF SEVERE ECONOMIC DISTRESS BOTH URBAN AND RURAL. THAT USUALLY, ALTHOUGH NOT ALWAYS, MEANS AREAS OF HIGH UNEMPLOYMENT CONTAINING RESIDENTS WITH LOW EDUCATIONAL LEVELS AND FEW OCCUPATIONAL SKILLS. FURTHER, OUTDATED OR INADEQUATE PUBLIC SERVICES SUCH AS WATER/SEWER FACILITIES AND TRANSPORTATION, HIGHER CRIME RATES AND POOR POLICE AND FIRE PROTECTION ARE CHARACTERISTIC OF SUCH AREAS PARTICULARLY IN AN URBAN SETTING. THIS ALSO USUALLY MEANS A HIGH CONCENTRATION OF MINORITIES IN URBAN AREAS. TAX INCENTIVES WILL NOT ADDRESS THESE PROBLEMS AND THEY CANNOT BE REMEDIED BY BUSINESS, PARTICULARLY SMALL BUSINESS, MOVING INTO ENTERPRISE ZONES. IT IS IN FACT, THOSE KINDS OF SERVICES THAT MUST BE PROVIDED BY LOCAL GOVERNMENT IN ORDER TO ATTRACT ECONOMIC ACTIVITY INTO AN AREA IN THE FIRST PLACE. WITHOUT ADEQUATE PUBLIC SERIVCES, BUSINESS WILL SIMPLY NOT LOCATE IN DISTRESSED AREAS.

IN ADDITION, JOB TRAINING AND MANPOWER PROGRAMS, RECREATIONAL BENEFITS, ADEQUATE HOUSING AND OTHER SUCH AMENITIES ARE ESSENTIAL IN ORDER TO ATTRACT COMPANIES TO DETERIORATED AREAS. ALSO, ADEQUATE POLICE AND FIRE PROTECTION WILL HAVE A DIRECT IMPACT ON LIABILITY INSURANCE FOR COMPANIES LOCATING IN THESE AREAS AND IT IS CRITICALLY IMPORTANT THAT SUCH PROTECTION BE PROVIDED. I AM ALSO CONCERNED ABOUT ADEQUATE TRANSPORTATION OF SUPPLIES AND PRODUCTS IN AND OUT OF ENTERPRISE ZONE AREAS. OFTEN THESE LOCATIONS ARE NOT SITUATED NEAR MAJOR TRANSPORTATION ROUTES AND COULD BE A HINDRANCE IN A COMPANY'S DECISION TO LOCATE IN AN ENTERPRISE ZONE AREA.

TAX CREDITS FOR DISADVANTAGED WORKERS, THE ELIMINATION OF CAPITAL GAINS TAXES, REDUCTIONS IN CORPORATE INCOME TAX RATES ARE OBVIOULSY BENEFICIAL TO BUSINESSES. CERTAINLY SUCH BENEFITS WOULD ENCOURAGE BUSINESS ALREADY LOCATED IN ENTERPRISE ZONE AREAS TO REMAIN IN A LOCATION OR EXPAND THEIR ACTIVITIES. THE INSTITUTE STRONGLY RECOMMENDS THAT SUCH INCENTIVE BE APPLIED TO EXISTING BUSINESSES IN THOSE AREAS. HOWEVER, SPECIAL TAX CREDITS WILL NOT PROVIDE THE CAPITAL NEEDED FOR BUSINESS TO CONSTRUCT FACILITIES IN ENTERPRISE ZONE AREAS ANYMORE THAN TAX CREDITS WILL PROVIDE THE NECESSARY INFRASTRUCTURE AND POLICE AND FIRE PROTECTION.

IN THAT REGARD, LOCAL DEVELOPMENT CORPORATIONS (LDC'S) THROUGH THE AVAILABILITY OF BONDING AUTHORITY AND OTHER MEANS WILL HAVE TO ASSIST WITH CAPITAL FORMATION. ALSO, TRADITIONAL FORMS OF ASSISTANCE SUCH AS THE SMALL BUSINESS ADMINISTRATION PROGRAMS, THE ECONOMIC DEVELOPMENT ADMINISTRATION AND HUD'S URBAN DEVELOPMENT ACTION GRANT PROGRAM MUST BE AVAILABLE. AVAILABLE NOT ONLY TO ASSIST BUSINESS WITH CAPITAL FORMATION BUT ALSO TO HELP LOCAL GOVERNMENT

TO BUILD THE NECESSARY INFRASTRUCTURE. UNFORTUNATELY, THAT TYPE OF ASSISTANCE IS EITHER BEING DRASTICALLY REDUCED OR CUTBACK ALTOGETHER.

FINALLY, MR. CHAIRMAN, I WOULD LIKE TO STRESS THE ABSOLUTE NECESSITY OF ASSISTING THOSE BUSINESSES ALREADY LOCATED IN ENTERPRISE ZONE AREAS AND ALSO THOSE WHICH EMPLOY LARGE NUMBERS OF RESIDENTS FROM THOSE AREAS. FOR EXAMPLE, I WOULD ENCOURAGE YOU TO CONSIDER SOME TYPE OF TAX CREDIT FOR FIRMS HIRING UNEMPLOYED OR DISADVANTAGED RESIDENTS FROM ENTERPRISE ZONE AREAS EVEN IF THOSE FIRMS ARE NOT LOCATED IN THE ZONE. GIVEN THE LACK OF AVAILABLE CAPITAL FOR CONSTRUCTION, THIS WOULD BE AN EXCELLENT VEHICLE TO ENCOURAGE THE HIRING OF RESIDENTS FROM DISADVANTAGED AREAS. CERTAINLY SUCH TAX ASSISTANCE WOULD HELP AN EMPLOYER OFFSET THE COST INVOLVED IN TRAINING THESE WORKERS OR PROVIDING OTHER NEEDS SUCH AS TRANSPORATION.

IF THIS CONGRESS CAN PRODUCE LEGISLATION THAT ATTACKS THE PROBLEMS FACING DISTRESSED AREAS THROUGH THE USE OF A VARIETY OF TOOLS, THEN PERHAPS BUSINESS WORKING IN COOPERATION WITH FEDERAL, STATE AND LOCAL GOVERNMENTS CAN MAKE A DIFFERENCE. TAX INCENTIVES ALONE WILL SIMPLY NOT DO THE JOB.

MR. CHAIRMAN, ON BEHALF OF THE AMERICAN HEALTH AND BEAUTY AIDS INSTITUTE AND M & M PRODUCTS, I THANK YOU FOR THIS OPPORTUNITY TO PRESENT OUR VIEWS AND WILL BE HAPPY TO ANSWER ANY QUESTIONS.

ATTACHMENT

News Smith, Jones and Asso[illegible] Inc.

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312/644-6610

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November 12, 1981

FOR IMMEDIATE RELEASE

BLACK HEALTH AND BEAUTY AIDS MANUFACTURERS FORM ASSOCIATION

Smith, Jones and Associates, Inc. has announced the formation of the American Health and Beauty Aids Institute representing manufacturers of black health and beauty aids products.

The Institute has been formed to contribute to business development and industry growth, thereby increasing the potential for individual member company profitability. It seeks to represent the interests of its member companies and the industry to governmental agencies at the local, state and federal levels. Additionally, the association will maintain effective communications between its members, the industry and the minority community its members serve.

The charter members are Bronner Brothers, Inc., A. W. Curtis Laboratories, The Hairlox Company, Inc., Johnson Products Co., Inc., Luster Products Co., M & M Products Company, The Madame C. J. Walker Mfg. Company, Pro-Line Corporation, Soft Sheen Products Co., Inc. and U DO IT Beauty Products, Inc. These companies represent nearly $150 million in annual gross sales of hair care and other health and beauty aids products to the black community. They spend more than $100 million on packaging, raw materials, advertising programs, insurance programs and transportation services and provide more than $25 million in annual salaries to nearly 1,500 black employees.

Serving as the association's first elected chairman is George Johnson, chairman of the board, Johnson Products Co., Inc., Chicago. Other elected officers are: first vice chairman, Cornell McBride, president, M & M Products Company, Atlanta; second vice chairman, Comer Cottrell, president, Pro-Line Corporation, Dallas; secretary, Fred Luster, president, Luster Products Co., Chicago; treasurer, Ed Gardner, president, Soft Sheen Products Co., Inc., Chicago; parlimentarian/historian, Marcus Griffith, president, The Hairlox Company, Inc., Washington, D.C.

Lafayette Jones has been named the Institute's executive director. Jones is president and co-founder of Smith, Jones and Associates, Inc., a recently formed management firm serving minority trade associations and professional societies.

Smith, Jones and Associates is an affiliate of Smith, Bucklin & Associates, Inc., the nation's largest association management firm representing more than 70 association clients from offices in Chicago and Washington, D.C.

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PROFILES. . . .

American Health & Beauty Aids Institute Charter Member Companies

Typed below are short profiles of the 10 charter members of the American Health and Beauty Aids Institute. Additional information on the companies can be obtained through Institute headquarters or by contacting companies directly.

Bronner Brothers, Inc., Atlanta, Ga.

Bronner Brothers is best known in the beauty industry for its annual International Beauty Trade Show, held in Atlanta, which draws nearly 15,000 beauty professionals plus 150 leading health and beauty manufacturers as exhibitors. Founded nearly 35 years ago by President N. H. Bronner, Sr., the company is also a leading manufacturer of hair care products sold nationally under the Cosmopolitan Curl and BB labels. With 65 employees, the company operates four stores, two manufacturing plants and one warehouse, all in Atlanta.

A. W. Curtis Laboratories, Detroit, Mich.

Founded in 1955 by current president Austin W. Curtis, the company has grown and diversified over the years. A close associate and protege of the late pioneer researcher Dr. George Washington Carver at Alabama's Tuskegee Institute, Curtis has utilized Carver's research with peanuts to successfully manufacture a rubbing oil for arthritis relief. That nationally distributed ointment, as well as a line of hair care products, are sold under the Curtis label. All are manufactured at Curtis' Detroit headquarters which employs 15 persons.

Founder Curtis is a member of the Michigan Small Business Alliance, the Booker T. Washington Business Association and active in many Detroit area civic organizations.

The Hairlox Company, Inc., Washington, D. C.

Although Hairlox was formally incorporated in 1970, founder and company President Marcus M. Griffith has been involved in the black health and beauty industry for over 30 years. Originally with the Fuller Products Co., Griffith founded the Beautyrama salon chain and Beauty Queen product line in the 1950s which soon became the largest black-owned business in the Washington, D.C.-Baltimore markets. The salons were also the nation's first minority business to secure a Federal Credit Union charter for employees. In the late '60s and early '70s Griffith went on to found several Beauty Fair hair salons in the Washington, D.C. market.

Hairlox employs 28 persons and manufactures a complete line of hair care products sold in the U.S. and 15 foreign countries.

American Health & Beauty Aids Institute

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Johnson Products Co., Inc., Chicago, Ill.

With 1980 sales over $40 million, Johnson Products Co., Inc. is one of the nation's leading health and beauty aids manufacturers. Founder and President George E. Johnson formed the company in 1954, which today boasts approximately 500 employees and more than 150 personal care products which are marketed to consumers on four continents (Africa, Europe, North America and South America). The company recently expanded its international operations with construction of a multi-million dollar manufacturing plant in Lagos, Nigeria. The Johnson Products Research Center is considered to be the largest research and development facility in the world devoted exclusively to the development of beauty and hair care product needs for black consumers, with a staff of some 44 chemists, engineers and technicians.

The company's philantrophic activities are administered by the George E. Johnson Education Fund and the George E. Johnson Foundation. Since its inception in 1972, the Educational Fund has provided college scholarships to more than 500 needy students in the fields of business and hard sciences. The Foundation extends financial assistance to some 140 civic and social welfare organizations nationwide.

Luster Products Co., Chicago, Ill.

President Fred Luster, Sr., long involved in the black hair care industry, founded Luster Products in 1967. His business philosophy: produce quality merchandise, keep your customers happy, pay your bills and have faith in yourself to succeed in all your endeavors. Based upon that philosophy, the company today boasts a nationwide line of hair care products including S-Curl and Pressing Comb in the Jar. Luster Products employs 30 persons, all at its Chicago headquarters.

M & M Products Company, Atlanta, Ga.

Founded in 1973 by Cornell McBride and Therman McKenzie, M & M's success has been nothing short of phenomenol. In 1979 the company was 43rd in a ranking of the nation's largest black businesses compiled by Black Enterprise magazine. In 1980 the company jumped to 13th place with record sales of over $25 million. M & M manufactures a complete line of ethnic hair care products including the popular Sta-Sof-Fro and Sof 'n Free, all developed at the company's Atlanta-based laboratories. The company employs some 400 persons, and its products are sold in the U.S., Canada, England and Nigeria.

A supporter and contributor to the National Urban League, United Negro Fund and National Association for the Advancement of Colored People, M & M also supports scholarship programs at Fort Valley State College and Savannah State College in Georgia. Active in the fight against sickle cell anemia,

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and Los Angeles. The Chicago-headquartered company, formed in 1964 by Edward G. Gardner, is a major manufacturer of black hair care lines, notably Care Free Curl and Miss Cool hair care products. The company employs 200 persons in its Chicago plant and another 100 part-time agents nationwide.

The company is involved in many community civic activities, including its support of an inner city Los Angeles Boys Club and an 'adopt-a-school' service and training program with a Chicago high school. For its own employees, Soft Sheen stresses continuing education and awards employee scholarships to Northwestern University's Graduate School of Management.

U DO IT Beauty Products, Inc., Gardena, Calif.

Although a young company, U DO IT's complete line of hair care products have successfully entered the Los Angeles market and are increasingly sold both retail and in salons throughout the country. Founder and President Melvin Calloway formed the company in 1978 utilizing his diverse marketing and sales background in the black beauty industry. In the '60s and early '70s Calloway headed Bunny's, the nation's largest black wig company. The company operated 10 retail stores in the Los Angeles market. Bunny's wigs also were sold to department stores throughout the U.S. U DO IT employs 12 full-time persons and an equal number part time in sales and research. The company also pioneered the concept of the U Curl, a popular hair care development.

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the company sponsors several marathons annually in major U.S. cities with proceeds going to sickle cell research. And branching into the entertainment arena, M & M will be the 1981-82 underwriter of PBS's "The Righteous Apples," the critically acclaimed and first black-produced television series to be aired in prime time.

The Madame C. J. Walker Mfg. Company, Indianapolis, Ind.

An institution in the black health and beauty field, Madame C. J. Walker was the nation's first black female cosmetician to receive widespread commercial success. The company was founded in 1903 by Madame Walker who established a complete line of hair and skin care products sold door-to-door. Although Madame Walker died in 1919, her business thrived. For years the company operated several successful Madame Walker beauty schools from Washington, D.C. to Kansas City. Today the company is embarked on a rejuvenation program to manufacture and nationally market hair and skin care products. Current company president is A'Lelia Nelson.

Perhaps the ultimate testimony to Madame Walker's legacy is the Madame Walker Building in Indianapolis, once a major cornerstone of black cultural activities, including a renowned theater. The building, designated a national landmark and still housing the company, recently received a $1.5 million federal grant for renovation as the Madame C. J. Walker Urban Life Center.

Pro-Line Corporation, Dallas, Texas

Ranked 14th in 1980 sales among all U.S. black businesses by Black Enterprise magazine, Pro-Line was founded in 1970 by Comer J. Cottrell, current company president. The company, which manufactures a complete line of hair care products and employs 280 persons, had sales of $22.6 million in 1980. Pro-Line's success can be partially attributed to an aggressive nationwide marketing program to promote its hair products, including its successful Curly Kit.

Founder Cottrell is an ardent member and supporter of several civic and professional groups including the Dallas Chamber of Commerce, the Black Chamber of Commerce and the Dallas Minority Business Center.

Soft Sheen Products Co., Inc., Chicago, Ill.

Soft Sheen's vitality in the black beauty industry can best be exemplified by the planned opening of distribution centers in Dallas and Atlanta (scheduled for late 1981) to supplement existing facilities in New York City

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THE PREPARED STATEMENT OF WILLIAM F. LYTLE

Chairman Boschowitz and Members of the Committee:

My comments regarding this new and welcomed legislation are directed at the problems of business development in urban areas and the programs the Federal Government can undertake to resolve some of them. These comments are derived from my experiences in developing and managing small business operations (of less than 100 employees) in distressed urban communities; communities that I am sure would qualify as "Enterprise Zones" under this new legislative proposal. I have been involved with small business development in these communities for the past 16 years. The first four years as a small business consultant involved in the development of minority owned businesses. The last ten as owner and manager of two small businesses, both located in depressed urban communities. These experiences do not necessarily make one an expert on business development in economically depressed areas, but they certainly have provided me with a perspective on the problems associated with operating them.

I would like to preface my comments on this subject by stating that I have had very little information available to me on the proposed "Enterprise Zone" legislation. As I understand it, the principle objective of this proposal is:

> "To create the necessary incentives for businesses to locate within or expand their existing operations in distressed urban communities."

I have assumed that "Distressed Urban Communities" would be defined as ones of

- High Unemployment
- Extensive Physical Deterioration
- Relatively high percentage of the area population receiving government assistance.

The benefit of this new business activity would be to overcome these problems ie:

- To create jobs that provide immediate income for Zone residents and provide them with skills that will enable them to take advantage of other employment opportunities outside of the Zone area.
- To increase investment in these areas that, in addition to providing for productive work activities, will improve the physical appearance of the community.
- To reduce government financed family assistance programs that provide support for some of the Zone residents.

In discussing the problems of operating businesses in these areas I found it easiest to group them into the general topics that comprise some of the basic functions of a business. Recomendations that may be appropriate for inclusion in the pending legislation follow the general overview of problems.

In any business enterprise it is the management that defines the direction for the business and brings to it whatever resources are necessary to enable it to conduct it's operations properly. It is the capability of this management that most influences the potential success or failure of the business enterprise.

In developing businesses in economically depressed urban areas, the business manager has the additional tasks of dealing with the problems of personnel development and crime associated with operating in these locations. These additional burdens have discouraged many white business managers from establishing and expanding their business operations in these areas. The development of minority-owned businesses, managed by minority residents of the area, or those who could operate businesses in the area, has proceeded very slowly. The attempts to develop businesses owned by the residents of depressed urban areas have not always been undertaken by those people who have the necessary business management skills that would enable them to make their businesses sucessful. The majority of the people who reside in these areas have had very little opportunity to be exposed to business management. Many times the extent of their management experience is the supervision of their fellow direct labor employee's. Most minority managers that have developed the skills necessary to operate a small business have developed them inside of some other business enterprise. Once achieving these skills and the rewards that go with them, they are reluctant to leave these places of employment to venture out on their own and undertake the development of a small business. Substantial inducement must be provided to encourage these people to leave their hard won positions of management to undertake the development of a small business. These inducements could also encourage white entrepreneurs to look more favorabley on depressed urban areas to establish and expand their enterprises.

The small businessman has to operate in many different areas of his business in order to make sure it functions properly. Since his operation is not large enough to employ a number of specialists in each of the basic disciplines of his business, he must be functional in general management, sales, finance, operations, personnel and purchasing. As he does not have time to function in all of these areas effectively, he typically gravitates to those areas he enjoys or that have obvious problems, and provides very little time for other functions.

Usually one of the key areas that is often overlooked is the area of financial management and cost control. Small businessmen often rely exclusively on their accountants to provide them with information on the financial status of the business. The small business manager often does not comprehend the financial statements provided to him and of course once this information has been developed, it is past history and may be provided too late to correct the problems that the financial statement reveals.

As the business begins to grow and requires experienced supervisors or managers to control specific functions of the operations, often new management problems occur. Many times these managers have to be recruited from outside the area. Many experienced managers do not want to work in economically depressed areas. In the case of minority owned businesses, recruitment of white managerial help is an additional problem. New managerial candidates are not only reluctant to come to the area, but are skeptical about working for a minority-owned firm.

The problems of marketing are not problems unique to businesses located in economically depressed areas, but are general problems of all small businesses. The ability to clearly identify a market for the firm's goods and services and to develop the capability to reach that market to sell the firm's goods or services is a key ingredient to the development and expansion of any business operation. Too often small business people do not have access to the major purchasers of their goods or services or do not have the resources necessary to extend themselves to some of these major purchasers. A clearly identified and accessible market for the firm's products, along with managerial skills are the most crucial factors in the firm's ability to develop and expand.

Firms that have a minority ownership have a particular problem in marketing their products. Potential purchasers do not have confidence that the minority firm has the ability to provide these goods and services. This credibility problem can often be overcome by the establishment of a good business relationship with a generally recognized, major firm. This relationship will give the marketplace the assurance that the small business can perform up to a certain standard and is therefore no longer a risk for other potential purchasers to consider it's products or services.

Most small businesses do not have sufficient financial resources to properly advertise or promote their business. Since it is very difficult to measure the benefits derived from these activities, small businessmen tend to concentrate more on personal contacts to perform this function. Small businessmen also have problems breaking into the normal channels of distribution, (this is especially true for small manufacturing firms producing commonly used items). Often, consumer products are sold on the basis of brand recognition created by the competitor's long time existence in the marketplace or by their advertising. The typical vehicle used for gaining access to the distribution system for a small business is on the basis of a lower cost product or by providing a special service that is not available from it's competitors.

The task of obtaining money at reasonable costs to begin and develop a business is a problem for all business managers. The problem becomes more acute when that small business is located in an economically depressed area. Banks are reluctant to provide loans to the small businesses located there. They typically look upon these firms as very high-risk business enterprises. There is also very little venture capital money available to a small business person to supplement any bank loans that they can obtain. If venture capital money is available it is usually provided as additional debt. The Small Business Administration has loan programs to support the development of small businesses. They also have some special programs geared toward the development of minority owned small businesses. Most of these programs, however, have featured debt as the prime vehicle for financing a small business operation. This debt adds substantially to the firm's cost of doing business and oft times drains too much of the working capital that is needed for it's development and expansion. Typically the debt is structured to be paid back over a relatively short period of time with principle payments to be made almost immediately upon the disbursement of the loan. Small businessmen often find themselves pledging all of their personal assets as a security to obtain loans for their business operations. This requirement remains long after the business has accumulated sufficient net worth to more than provide the security necessary for the loan.

Because there are very few venture capital firms who will provide equity money, the small business person is limited to their own resources and the resources of their family and friends for the seed capital they need to start their business. Too often the businesses are started with a substantially higher debt component in the capital structure than the business can support. This debt is typically allocated to meet the immediate operational needs of the business. In addition to placing a substantial burden on it's working capital, a business that is heavily debt financed can not adequately respond to changes in market conditions that require it to develop new capabilities.

For the most part when we talked about economically depressed urban areas we are talking about areas that have a large minority population. We can also characterize this population as consisting of people with relatively low job skills and poor educational background. These characteristics, out of necessity, dictate that the businesses to be established and expanded in these areas are businesses that can initially utilize a low skilled labor force.

Many of the residents of this area are young people who have not had any long term work experience. This labor force therefore, requires some indoctrination into the working environment. Many of the teenagers have to learn to work within an organized structure. The problem is not one of willingness to work or cooperate, but to specifically go through a training phase to learn the particular skills that are necessary to function on the job. Because of the low skilled level of the potential employee, the wages available for these types of jobs are necessarily low and oft times do not provide sufficient incentive (particularly for the younger people) to stay with the job long enough to gain skills and proficiency that enable them to make a contribution to the business.

When an employee has developed the necessary skills to become totally functional in the business operation, a reverse problem occurs in that with these new skills, the employee finds himself marketable to other larger corporations that can pay higher wages than the small business. As these opportunities occur, the employee with it's newly developed skills moves out to the "greener pastures" of the larger corporation. In effect, the small business becomes the training vehicle for entry level people and has a relatively high turnover of people either starting to work, becoming discouraged and leaving,or developing skills, realizing their potential and moving on to higher paying jobs. This high turnover rate increases the business's cost for training and quality control.

Sometimes there are limitations to the training that can be provided because of the inadequate public education that is provided in these areas. Many of the employees can not read and comprehend written instructions and have a difficult time doing simple arithmatic and maintaining records. Sometimes people with leadership skills can not be promoted to levels of supervision because they can not do the administrative tasks associated with the supervisory responsibilities. This problems has nothing to do with the basic capability of the individual to learn new skills, but is strictly the limitation of their educational experience.

Much of the space available to house businesses in the target areas are very old and in need of substantial renovation. The renovations required to improve them must minimise the energy required to heat them and secure the building from break-ins. This last point is most important because too often the cost of obtaining insurance for business operations in areas of this type are excessively high if it can be found at all. Some small businessmen find this cost to be so burdensome they take the chance of operating without the necessary theft insurance protection.

In addition to the physical security to protect the plant from theft when business is not occupied, security provisions have to be provided during operating hours to ensure that unwanted visitors can not impose themselves on the employees.

The existence of other monitored safety systems like sprinkler, burglar and fire alarm systems can offset the insurance costs of these operations. Many of the existing buildings do not have these systems in place. They also occur as additional costs for the small business person, in either extra insurance burden or additional installation costs. Because of the high crime problem in these areas, additional security construction has to be provided in the parking areas, as well.

RECOMMENDATIONS FOR ENTERPRISE ZONE LEGISLATION:

1. *Management Assistance* support to the small business people is necessary to enable them to comfortably control the many functional areas of their business. Resource people need to be available to help the new entrepreneurs develop skills in areas that they have not been previously trained. This management assistance could be provided by special consulting firms contracted by the Federal Government who have an appreciation for the problems associated with operating a small business, or by the personnel of the major corporations with whom the firm does business. If the personnel of a major corporation are used in this manner, the value of the assistance they provide could be added to the price bonus discussed in recommendation No. 3.

2. *The Federal Government purchases* goods and services of every type and description. Firms located in Enterprise Zones, employing Enterprise Zone residents, could be given special considerations for contracts to provide these goods and services. These contracts could be awarded on a set-aside basis to qualifying Enterprise Zone firms.

3. *Prime Contractors* to the federal government purchases goods and services to support their operations and also have sub-contract work to be performed. They could be induced via "price adjustment bonuses" to purchase goods, services or sub-contract items from firms located in Enterprise Zones. These price bonuses could be increases in the monies they would receive from the government contracts and would be based upon the dollar amount of goods, services and sub-contract items they purchased from Enterprise Zone firms.

4. *Reduction in Federal Taxes* could be provided to any business who purchases goods or services from firms located within Enterprise Zones. These tax re-

ductions should be based upon the dollar amount of purchases the business makes from Enterprise Zone firms.

5. Long Term, Low Interest Loans could be provided by the government to be a low cost source of money to help finance new business activities. These loans could include warrents for the purchase of stock in the more successful companies. These warrents could be sold back to the company or to other interested investors. This debt should be structured such that the principle payment is lighter in early years of the loan to enable the company to retain cash for development and expansion.

6. Reduced Income Taxes for businesses located in the Enterprise Zones.

7. Equity Investment Stimulation. The federal government could provide tax incentives for individuals or corporations to make investments in Enterprise Zone companies. Reductions in personal/corporate income taxes at the time of the investment, and reduced capital gains tax at the time of sale could induce investment.

8. Capability Development for Enterprise Zone companies doing business directly with the federal government. Funds to purchase production equipment that can make the firm's cost lower during the conduct of the contract could be provided. Cost improvements derived from the new equipment could enable the company to reduce it's price for the product it is producing under the contract and will enable price reduction to be made on all furture contracts.

9. Government Surplus Equipment. The government has substantial amounts of equipment that it has provided to it's prime contractors which are surplus to the contractors and to the government. This surplus equipment is either

located in government owned facilities or at the prime contractor's place of business. Some of this equipment could be utilized by Enterprise Zone companies to conduct their operations and thereby lower their overall cost of doing business. This would also reduce the capital required to finance their operation.

10. Advance or Progress Payments for Enterprise Zone companies doing business directly with the federal government. These payments would enable the firm to cover the early cost of the contract without having to borrow additional working capital that could add to the companies cost of doing the work.

11. Personnel Development. The WIN Program has been an excellent program developed by the federal government to encourage employers to provide jobs to people who are receiving AFDC. This program provides federal tax credits for companies who employ welfare recipients. In addition, training monies are provided by the states to supplement the company's initial cost of hiring and training. Due to federal budget cutbacks, this training component has been eliminated and there is some question as to how long the WIN Program will be supported by federal and state governments. If economic development is to occur in economically depressed areas, programs like this must be increased rather than reduced. This program has been a cost effective program for the government and has saved the government more money than it has expended for it's support. In addition to providing incentives for companies to hire welfare recipients, this program has an impact on the overall family structure by changing the attitude's of newly employed welfare recipients and their children.

12. Education. Although this recommendation does not fall directly within the domain of the Senate Small Business Committee's activity, it has a direct bearing on the issues being discussed. Standards need to be developed for

the educational systems throughout the country to insure that children receive a good foundation in the basic education fundamentals of reading, writing and basic math. This is particularly crucial to people who reside in and are educated by the public schools in economically depressed areas. Without these basic skills, children educated in these systems are handicapped when entering the job market and are all but eliminated from obtaining opportunities for high skill, higher paying jobs. Performance levels should be established at each grade of the educational systems to insure that the children who pass through that system are developing along predictable paths. Paths that will yield them sufficient education to develop special working skills. Without this renewed emphasis on basic fundamental skills in the educational process, the people who pass through these school systems will have little or no chance to change their economic status. This is even more critical as we look into the future and see that more and more of jobs that will be developed, will be technical in nature and will require better basic educational skills.

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CAREY
MACHINERY & SUPPLY CO., INC.

Statement of G. Cheston Carey, Jr.
President, Carey Machinery & Supply Co., Inc.
Before the Senate Small Business Committee

"INCENTIVES FOR SMALL BUSINESS IN ENTERPRISE ZONES"

My name is Cheston Carey and I am President of Carey Machinery & Supply Company, a distributor of industrial supplies in Baltimore since at least 1887. I appreciate very much the opportunity to appear here today.

In attempting to respond to your investigation of what principal factors would foster small business creation and expansion in such distressed areas as are contemplated for designation as enterprise zones, I wear several different hats. Your understanding of these roles, all of which have contributed to my responses, should be useful in evaluating my remarks.

First, I come as a small businessman, President of a company that for most of its existence has employed fewer than 100 people.

Secondly, I appear, thanks to the National Association of Wholesaler-Distributors (NAW), as one of 45,000 of its members who has an interest in this kind of legislation. Wholesaler-distributors, many of whom are located in the inner-city, have a vested interest in the revitalization of distressed urban areas. We can provide much needed credit, financial and management advice to newly created small businesses in enterprise zones, and may possibly benefit from establishing new or annexed businesses in such zones.

Thirdly, I serve on a subcommittee of the Greater Baltimore Committee, charged specifically with the task of reviewing the pending legislation and literature on the subject of enterprise zones.

Finally, I appear as an unabashed Baltimore booster -- one of a steady procession of such people to Washington to remind Congress that we have an enterprise zone in Baltimore called Park Circle already underway, waiting eagerly to compete for designation as the first federal enterprise zone, once legislation has been passed.

Since the report, issued in July of 1981 by the Greater Baltimore Committee, covers many aspects of the subject in addition to the subject of today's hearings, I shall not try to summarize all of our findings, but have included copies of it with the written statement submitted to your Committee.

Let me say at the outset that small business, with the possible exception of minority-owned and run businesses, will not, for the most part, be attracted to enterprise zones for any of the social or political considerations now beginning to play a part in location decisions of some of our large companies. Therefore, the enterprise zone legislation and implementation, to attract the small business person, must provide measurable early benefits to him that clearly outweigh the drawbacks of such a location.

For this reason, I would have to agree most strongly with those who argue that any approach which relies almost exclusively on tax credits will have little or no effect on attracting most small business to enterprise zones. On the one hand, existing small businesses which might be attracted to such zones would tend to be inner-city businesses already, probably of marginal profitability and thus unable to calculate much in the way of tax savings through credits, abatements and the like. On the other hand, new businesses of the kind that could and should be the most desirable to attract are typically not profitable for several years. Thus, although tax credits with liberal carry-forward provisions and shelter for capital gains should be left in the legislation as incentives for the more farsighted -- alone they mean very little.

Let me hasten to add, however, that I firmly believe the tax incentive package should remain as an incentive to attract the medium and large size businesses to such zones. Too much of the talk about this legislation has focused on small business alone, implying for one reason or another that the bigger ones would not help and hence should not be lured. I say this is nonsense. As a small businessman, I would be delighted to see Control Data, the C & P Telephone Co., and Commercial Credit as my neighbors. This is what has already happened in our "pre-packaged" enterprise zone at Park Circle in Baltimore.

But back to small businesses like ours. What can be done to attract us? First and foremost, easily available, inexpensive seed capital. Regardless of what you may think, it is not and, to my knowledge, never has been readily available from existing government sources. As chairman for seven years of the Baltimore Council for Equal Business Opportunity (CEBO), a minority business packaging and counseling organization, I was painfully aware of the tortuous process our staff had to follow to find funds, beset by administrative blind alleys, bickering, delay, battles for turf, etc., often culminating in a rejection due to exhaustion of funds for another quarter or even another year.

Venture capitalists just aren't interested in these kinds of investments for the most part, on terms anywhere near acceptable to an entrepreneur just starting his business. Much as we would like to think otherwise, we are not going to create more Route 128's or Silicon Valleys or, as I hear they now forecast, Germanium Gulches. As for banks as a source of loans, Dr. David Birch put it as well as anyone could when he wrote "the job generating firm tends to be small. It tends to be dynamic (or unstable, depending on your viewpoint) -- the kind of firm that banks feel very uncomfortable about."

Just how seed capital could be provided, I'm not sure. But I don't believe the amounts required are large in relationship to normal government grants, and the money could be made to go a long way through loan guarantee programs with local banking involvement, or some form of leveraging for locally provided capital which has been done with SBICs.

Once having addressed the problem of seed capital, the legislation must next focus on reducing operating expenses, if the small business is to be attracted. As I have stated, those already in business who are still in the inner-city are probably marginal and hardly looking for salvation through sheltered capital gains. What might excite them, however, would be concessions that could immediately improve their profit margins or, in the case of new businesses, minimize their losses. I honestly hate to see the legislation get bogged down in the bitter controversy over a lowered minimum wage, but I do believe there is major assistance that should be given in the early years such as refunds of some significant value for the hiring and keeping of CETA -- eligible employees. This refund (as opposed to tax credit carry-forwards, which could be conceived of as useless) should be limited to the first year, after which it should rightly become a tax credit.

Reduced government regulation at all levels, although not actually much of a help in cutting small business operating expenses, could be perceived as helpful.

Thirdly, small business needs outside support in significant quantities to make the equation appear favorable. It is instructive to recall a story that Control Data tells about its first inner-city plant where absenteeism was at a high level, especially on Mondays. When the company discovered that the reason seemed to be that many were in jail on Mondays, it posted a corporation attorney to the jail on Monday mornings to provide bail and assigned its human resources staff to extra counseling duties and solved the problem. No need to belabor the point -- small businesses can't afford such luxuries. But no one can reasonably expect the cities to serve up a ready supply of stable, skilled workers in these zones. If they could, we are wasting our time debating the enterprise zone concept. A middle ground, which I feel to be essential to the success of any enterprise zone effort, would mandate that such services be made available through a combination of federal, state, local and publicly-encouraged but privately run suppliers such as Control Data's Business and Technology Center, now under construction at Park Circle in Baltimore. These services should include: recruiting, hiring, skill and job training; counseling, including basics of how to hold a job; alcohol and drug abuse help, and; business services such as bookkeeping, legal and benefit planning.

Finally, the zone has to have increased police and fire protection if we are to attract the entrepreneur. Having spent a fair amount of time working with minority businesses, I personally don't worry about this, but I am constantly amazed at the reluctance on the part of some of my otherwise sophisticated employees to enter neighborhoods in which a zone might be established. Like it or not, it's something we have to address.

Being fairly well acquainted with the awesome demands on Baltimore's limited revenues after eight years on the Planning Commission, I would have to urge in the strongest terms that funding for services I have described, as well as the infrastructure improvements, should be provided by the Federal Government as part of this legislation. However, totally without the approval of our dynamic Mayor Schaefer I would take the stand that the legislation should mandate as a last resort that these services be provided locally, if not funded federally, before the rest of the provisions take effect. Without this kind of support, I doubt if small businesses would be attracted to the zones, but if they were, their chances of success and hence, the success of the zone concept, would be greatly diminished, if not extinquished.

Lest this sound like a rehashed version of big spending programs of the past, cloaked in free enterprise language, let me hasten to add several suggestions:

(1) The enterprise zone program should truly be considered an experiment, limited to no more than ten zones per year nationwide, ensuring that funding would be adequate to give the experiment a fair chance.

(2) There also should be some upper limits to the dollar amount of refunds, credits, relief and support services that could be furnished to any one company as well as a time limit on its eligibility for any benefits other than tax relief. We should not allow losers to stay that way too long.

(3) The companies that come to the zones might be allowed to choose among a variety of benefits and services up to a certain total dollar value per year per employee, cafeteria style. This is analogous to the concepts currently coming into vogue in personal benefit programs where the individual chooses what is best for him within limits established by the company. The logic behind the development of this approach to benefits is the same as the logic I am suggesting for enterprise zone legislation. We really can't be sure which benefits and services would mean the most to a company considering an enterprise zone, so let it choose for itself.

Small business is going to stay away in droves if you end up with complex legislation loaded with safeguards for public dollars. The only ones who will bother to apply will be those who already can afford high-priced lawyers and management consultants. Take a chance, keep it simple. No real money is going to be spent by the government if no one applies, starts a business, hires people and succeeds in making a profit. If some do, then we begin to accomplish our ends and the investment in such zones is repaid many fold.

Throughout my testimony, I have stressed the need for many services to be provided outside the tax abatement, tax credit areas. I am aware that enterprise zone legislation can go nowhere loaded with all sorts of new funding initiatives. Therefore, it seems to me (and did to our Greater Baltimore Committee Subcommittee) imperative that existing programs such as UDAG, EDA, CETA and IRB funding be kept in place. We do not view the enterprise zone program as an "urban policy" by itself, but as simply another tool to be used by the cities to continue the war on decay and the sad condition of the unemployed and disadvantaged. We have many statistics to prove how effective these other programs have been in Baltimore in revitalizing distressed areas, but rather than trying to recite them, let me suggest that you could much better understand them by taking a trip to Baltimore to see the results firsthand.

In conclusion, I would stress once again that the package of rewards that must be made available to small business to convince them to try enterprise zones must be a lot broader and more immediate than currently suggested tax credits and regulatory relief. The need is great to make it happen, but the obstacles to success are imposing. I am convinced, however, that it is worth doing "right" on a small scale the first time in hopes that we can find another urban initiative in which investment of tax dollars can truly be justified over the long run.

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 21, 1982

Mr. G. Cheston Carey, Jr.
President
Carey Machinery & Supply Co., Inc.
Post Office Box 206
Baltimore, Maryland 21203

Dear Mr. Carey:

I would like to personally thank you for testifying before the Senate Committee on Small Business on Thursday, February 25, 1982. I believe that through this hearing, we have begun to build a record of what small businesses need to develop in Enterprise Zones. Your testimony will be very helpful in evaluating proposals to establish Enterprise Zones.

Since the hearing, some Members of the Committee had additional questions, which have been enclosed with this letter. If you would be kind enough to respond to these questions in writing at your earliest convenience, it would be appreciated and helpful in completing the hearing record.

Again, thank you very much for your participation in what I believe was a very productive hearing.

With best wishes, I am,

Sincerely,

LOWELL WEICKER, Jr.
Chairman

Enclosure

Mail P.O. Box 206, Baltimore, Md 21203   Address 3501 Brehms Lane, Baltimore, Md 21213   Phone (301) 485-2323
CAREY
MACHINERY & SUPPLY CO. INC.

April 13, 1982

The Honorable Lowell Weicker, Jr.
United States Senate
Committee on Small Business
Washington, D. C. 20510

Dear Senator Weicker:

I was indeed glad to have the opportunity to testify before the Senate Committee on Small Business on February 25 concerning Enterprise Zone Legislation. I apologize for not answering your follow-up letter more promptly, but since the matter is still pending before the Congress, I hope my responses will still be timely.

The following are the specific questions you raised and my answers:

QUESTION A - What are your biggest concerns with the enterprise zone proposals as they stand now? Are there sufficient incentives to attract lenders and entrepreneurs?

ANSWER - (a) Too many zones are going to be created. (b) No provision for inexpensive seed capital. (c) No help in reducing operating expeneses. Tax credits for people who pay little or no taxes are not incentives. (d) No requirement that support services be furnished, nor funding for such services. (e) Legislation is growing too complex for small business to understand. In summary, there are not enough incentives to attract lenders and entrepreneurs for the local businessman.

QUESTION B - How will the budget reductions at the federal and local levels impact the need for improved services in areas designated as enterprise zones?

ANSWER - Budget reductions at federal and local levels will force the cutback of the kinds of support services which small businesses will need to survive in enterprise zones. Therefore, the furnishing of these services, if not legislated and funded, should at least be clearly identified as one of the key factors in the competition by cities for zone designation.

QUESTION C - Will insurance costs and the crime rate in any potential zone have a significant bearing on the potential for success of any zone?

ANSWER - The impact of insurance costs and crime rates will vary from zone to zone. Obviously where it is worse, it's impact will be the greatest. Since we cannot generalize as to the priorities of needed assistance from zone to zone, consider a unique approach that I suggested in my testimony.

> "The companies that come to the zones might be allowed to choose among a variety of benefits and services up to a certain total dollar value per year per employee, cafeteria style. This is analogous to the concepts currently coming into vogue in personal benefit programs where the individual chooses what is best for him within limits established by the company. The logic behind the development of this approach to benefits is the same as the logic I am suggesting for enterprise zone legislation. We really can't be sure which benefits and services would mean the most to a company considering an enterprize zone, so let it choose for itself."

I appreciate your continuing interest in my views. If I can be of further help, please don't hesitate to call or write.

Sincerely,

CAREY MACHINERY & SUPPLY CO., INC.

G. Cheston Carey, Jr.
President

GCC, Jr/jm

cc: Mr. Frank Gallagher
Greater Baltimore Committee

Mr. David Sloane
National Association of Wholesaler-Distributors

1981

GREATER BALTIMORE COMMITTEE'S REPORT ON ENTERPRISE ZONES

GREATER BALTIMORE COMMITTEE SUITE 900 TWO HOPKINS PLAZA BALTIMORE, MD 21201

GREATER BALTIMORE COMMITTEE, INC.

Report of the
Enterprise Zone Subcommittee
# of the
Greater Baltimore Committee

July 10, 1981

GREATER BALTIMORE COMMITTEE, INC.

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GREATER BALTIMORE COMMITTEE, INC.

Report of the
Enterprise Zone Subcommittee
# of the
Greater Baltimore Committee

INTRODUCTION

The Greater Baltimore Committee is a business organization with a membership of over eight hundred Baltimore area firms and is the Chamber of Commerce of Metropolitan Baltimore.

The Enterprise Zone Subcommittee was established by the Board of Directors of the Greater Baltimore Committee (GBC) on February 13, 1981 and subsequently appointed by Bernard Manekin, Chairman of the GBC. The Board of Director's action was taken in response to a letter sent to William Boucher, III, Executive Director of the GBC, by Congressman Jack Kemp (R-N.Y.), in which Mr. Kemp asked the Greater Baltimore Committee for its views on Enterprise Zones. The Enterprise Zone Subcommittee began work in early April and subsequently met many times. The meetings were held both among the members of the Subcommittee and with the attendance of various experts and interested parties who gave presentations and then answered questions.

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The guests who have advised the Committee are as follows:

Mr. Frederick E. Barrett, President
Sequerra Company, Inc.

Mr. Bernard L. Berkowitz, President
Baltimore Economic Development Corporation

Dr. Stuart M. Butler, Policy Analyst
Heritage Foundation

Mrs. Elizabeth Duklewski, Mr. James Duklewski,
and Mr. Sam Duklewski, Roberts Manufacturing Co.

Mr. Robert C. Embry, Jr., Formerly Assistant
Secretary of the Department of Housing and
Urban Development

Mr. Martin H. Kramer, Chief
Advanced Planning and Programming,
Department of Housing and Community Development

Ms. Mary McConnell
Congressman Kemp's Office

Mr. Lawrence Revzan, Director
Economic Development and Project Analysis Group,
Coopers and Lybrand

Mr. David M. Smick, Chief of Staff
Congressman Jack Kemp's Office

Mr. Herbert F. Trader, President
City Venture Corporation

The Subcommittee has also reviewed a large body of literature that has appeared about or in connection with enterprise zones and urban policy. Much of this material has served as the basis for theories espoused by proponents and opponents of enterprise zones. A list of information reviewed by the Subcommittee is set forth in the bibliography following this report.

As important as the information presented to the Subcommittee is the Enterprise Zone Subcommittee's composition.

The Subcommittee was selected to reflect the diversity of the Baltimore business community and those fields of business that would become active in enterprise zones should they come into being. Present within the makeup of the Subcommittee is the knowledge necessary to provide a business viewpoint analysis of a complex urban issue such as enterprise zones. Venture capitalists, bankers, economists, lawyers, accountants, builders, retailers, distributors, university educators, and residential, commercial and industrial developers are all represented. The Subcommittee was particularly careful during its deliberations to seek out the views and advice of small businesses.

After careful consideration of written information and information presented personally by experts and interested parties, the Subcommittee has reached some conclusions and feels able to make some suggestions regarding enterprise zones. The Subcommittee does not believe that it represents the complete expert on enterprise zones nor was this ever the Subcommittee's goal. Rather, the Subcommittee, through its members, has acquired a sufficient grasp of the issues involved to offer an informed view of the enterprise zone concept from the perspective of the business community of Metropolitan Baltimore. The purpose of this report is to provide a business insight into the concept with the hope that, as the recently introduced enterprise zones legislation is revised and implemented, these views will be considered where appropriate.

BACKGROUND AND PROPOSED LEGISLATION

The enterprise zone seemingly represents an attempt, through legislation, to create jobs in depressed urban areas through promoting an environment which is conducive to business start-ups and expansions. While there historically have been several similar business development policies and attempts, the enterprise zone concept now being discussed in the U.S. had its origin in United Kingdom where it was first proposed by Professor Peter Hall.

Enterprise zones are also new to the United Kingdom. Enterprise zone legislation was first passed in the fall of 1980 and is currently in the early stages of implementation. The enterprise zone concept in the U.K. calls for deep cuts in Government imposed taxes and regulations. Since it is realized that the enterprise zone is an unproven concept, the enterprise zone is viewed strictly as an experiment and the number of zones that may be established is limited to about eleven.

Of the enterprise zones being established in the United Kingdom, one of the most advanced is located in Clydebank, Scotland. Clydebank was once the site of a thriving shipbuilding industry which produced some of the world's greatest ships including the Queen Mary and the Queen Elizabeth. However, as the shipbuilding industry declined in the United Kingdom so did Clydebank. The Clydebank enterprise zone seeks to replace the now declined shipbuilding industry with other industries. This will require significant capital investment in the area. Larger businesses are, therefore, expected to play an active role in the redevelopment of Clydebank.

Also most noteworthy is the use of seed capital. As will be discussed later in this report, new businesses have a critical need for start-up money. At Clydebank a pool of seed money was created. Half of this money came from national accounts, and the other half was raised locally.

The American enterprise zone concept, as introduced and articulated by Stuart M. Butler, targets residential areas. Because recent studies indicate that small businesses account for most new jobs in America, proponents of enterprise zones are particularly interested in creating an environment conducive to small business start-ups and expansions. This is to be accomplished primarily through reducing business taxes in zone designated areas.

On June 3, 1981, Representative Jack Kemp (R-N.Y.) and Robert Garcia (D-N.Y.) introduced the Urban Jobs and Enterprise Zones Act of 1981 which represents the most recently proposed enterprise zone legislation. This legislation appears to have gained the initial approval of the Reagan Administration and many believe that enterprise zones will become a central part of the Administration's urban policy. Under this bill, a specific area of at least four thousand residents located within a city with high levels of poverty and unemployment may be designated as a zone.

The legislation proposes that within the zone the Federal Government will (1) eliminate capital gains taxes on investments; (2) exclude from income taxes half the income earned by enterprises located in the zone; (3) exclude interest income earned on loans to zone businesses from taxation; (4) extend the loss carryforward to twenty (20) years, thus allowing zone businesses to write off initial losses against long-term gains; and (5) allow businesses with gross receipts of two million dollars ($2,000,000) or less to use the cash accounting method, thereby potentially reducing tax burdens.

In order for a business located in an entperise zone to qualify for these tax reductions it must hire forty percent (40%) of its employees from among CETA-eligible workers. To further encourage the employment of disadvantaged workers, the Act offers a refundable income tax credit equal to five percent (5%) of the wages paid to CETA-eligible employees. Proponents of the legislation hope the disadvantaged will be encouraged to seek employment through the offer of a 5% refundable personal income tax credit for wages earned by all zone employees, up to a cap of one thousand five hundred dollars ($1,500). This provision is also designed as an incentive for skilled workers to seek employment in enterprise zones.

The legislation requires local governments desiring to have an enterprise zone located within their borders to commit to a course of action designed to reduce the various burdens borne by employers and employees in the zone. Such a program could include reductions in rates and fees; an increase in the efficiency of local services; and a commitment from private entities in the area to provide jobs and job training.

The Subcommittee recognizes the significance of this legislation and has given it consideration in writing its report. The Subcommittee has been most concerned with analyzing the conceptual framework of enterprise zones because the legislation is expected to be modified as it journeys through the legislative process.

ACTIVITIES OF THE CITY OF BALTIMORE

Perhaps more than any other City, Baltimore has given great attention and consideration to the enterprise zone concept. Baltimore City first expressed an interest in the concept over a year ago when the Department of Housing and Community Development invited Dr. Stuart M. Butler to come to Baltimore and explain the enterprise zone concept in detail to the Department's staff.

Since that time, an inter-departmental working group has been actively studying enterprise zones and Baltimore City officials have presented their views and support of enterprise zones in several forums nationwide. In an appearance before the Subcommittee, Baltimore City officials revealed that they have had four areas under study as possible sites for enterprise zones for some time.

Among the sites under study is the Park Heights area of Baltimore City. Park Heights seems to be well suited to the enterprise zone concept. Park Heights is a depressed area with high unemployment and is somewhat unique in that it is a residential area with good quantities of open land available for capital investments. Baltimore City has moved ahead with an aggressive business development program which has been substantially aided by federal programs which may be discontinued as well as being enhanced by private sector commitments to the area. Among the elements of the Park Heights effort are the following:

(1) An industrial park to be developed with great job density and acreage sold at low cost by the City.

(2) A City commitment to make street and utility improvements in the area of the industrial park.

(3) City Venture Corporation, a Control Data affiliate, will build a one hundred twenty thousand square feet (120,000 sq. ft.) "Business and Technology Center." The Center will provide low rents, counseling, typing, duplication, and other business services to embryo small businesses.

(4) Commercial Credit Company has opened a bindery plant which will eventually employ two hundred people, and C and P Telephone has invested in a new facility in the area.

(5) A counseling service for the unemployed gaining employment is being established.

The City hopes that its efforts will yield two thousand five hundred jobs (2,500).

In reviewing the Park Heights program, it is interesting to note that the local government commitments required by the new Urban Jobs and Enterprise Zones Act are already in place and, therefore, Park Heights is already an enterprise zone. All that is missing are the continuing and additional Federal commitments.

In addition, enterprise zone law has been enacted by the Maryland State Legislature with the support of the City. This enabling legislation was passed to ensure that Maryland law will not conflict with Federal enterprise zone legislation.

FINDINGS AND RECOMMENDATIONS

Objectives

Even among the proponents of enterprise zones, who congressionally represent the marriage of an apostle of new supply side economics and a patterned urban liberal, there appears to be a lack of a clear focus as to what economic goals it hopes to foster or achieve. As suggested earlier, the principal objective would appear to be the creation of a healthy and more creative business environment. From this background it is hoped there will come more entrepreneurs, and from the entrepreneurs will come successful businesses which will employ more people, particularly those who are chronically unemployed. A corollary principle of the enterprise zone seems to be a belief that those governmental programs which have gone before have involved large expenditures with relatively low achievement in terms of jobs or new business. Enterprise Zone proponents believe programs of direct assistance are doomed to failure because they will not reach a large enough portion of the total number of needy businesses.

When the enterprise zone concept is considered from the viewpoint of creating more entrepreneurial activity, emphasis is placed on the emergence or expansion of small business entrepreneurs. The reason for this emphasis is the expectation that more jobs will be created by small businesses in urban areas where unemployment is severe. This expectation is based on recent studies by the Massachusetts Institute of of Technology indicating that small businesses create more jobs in the aggregate than large businesses. The Subcommittee believes that enterprise zone legislation should not only encourage small business entrepreneurs, but that large business participation should be fostered as well. The Subcommittee draws this conclusion on the theory that a larger business may serve as an "anchor" in the development of a depressed area.

Evidence of the importance of investment by large businesses was brought to the attention of the Subcommittee during its deliberations. The Subcommittee learned that the economic development prospects for the Park Heights area of Baltimore City have been significantly enhanced by investments of two large firms. The Chesapeake and Potomac Telephone Company and the Commercial Credit Company are both investing in new facilities in the area. There is a sense that these investments by two major Baltimore firms will inspire confidence in the Park Heights area as a sound location for investment and, thereby, attract further investments.

The new Urban Jobs and Enterprise Zones Act of 1981 does not discourage activity within zones by large businesses and, in fact, allows them the same benefits as smaller businesses. The Subcommittee hopes that participation by larger firms will continue to have a place in the final version of enterprise zone legislation after the legislative process has concluded.

The Subcommittee is also concerned, however, that there not be an over concentration of larger businesses in enterprise zones. To this end, the Subcommittee recommends that a mechanism be devised and placed in the legislation to allow for the election of some large businesses for participation in enterprise zones. A key component and objective of this system should be to discourage large businesses from moving plants to enterprise zones from other areas thus adversely affecting those areas left behind. Only those large businesses wishing to open new plants should be encouraged to participate in enterprise zones.

Schematic Framework

Turning to the general scheme of enterprise zones, the Committee has some concerns. Regarding eligibility for employment within zones, the Subcommittee is concerned that an enterprise zone be sufficiently flexible to allow for the employment of chronically unemployed people residing within the entire contiguous metropolitan area and not from within the zone alone. If the objective of enterprise zones is to put the chronically unemployed to work, it makes little sense to exclude large segments of unemployed people from employment within enterprise zones. The Subcommittee hopes that the provision of the new legislation allowing for eligibility of all CETA-eligible people in a municipality will be maintained.

The Subcommittee sees no reason to target residential areas for enterprise zones designation alone. The major criteria in selecting an area for enterprise zone designation should be that area's economic development and job creation potential. To this end, declining industrial areas and areas containing large tracts of clear land may be much more promising than residential areas. Indeed, Baltimore City officials have non-residential areas under study which they believe would hold out great potential as enterprise zones. As noted earlier, the United Kingdom concept targets declining industrial areas such as Clydebank.

Business Development Concerns

The Subcommittee does not feel that the tax reductions will do much to solve the problems of small business development and thus relieve chronic urban unemployment. This belief is based both on the Committee's own collective experience and the very clearly expressed views of small businesses who addressed the Subcommittee. Small business representatives were not overly impressed with capital gains or income tax relief because they make little or no taxable income. What most concerned the small business interests was cheap or free seed capital, subsidies for cheap labor, cheap property, service amenities and facilities, and relief from burdensome federal, state and local government paperwork, such as licenses, permits, reports, etc.

The tax subsidies offered by enterprise zones may not be without impact. Some business earning a taxable profit, mostly larger businesses, could be influenced when making location decisions by, among other factors, the existence of tax subsidies in enterprise zones. As stated earlier, we believe the activity of these larger businesses in enterprise zones would be helpful. In addition, those smaller businesses that do earn a taxable profit may find tax subsidies attractive. Still, if the objective of enterprise zones is to encourage small business developments, tax subsidies alone are ineffective.

Virtually everyone who appeared before the Subcommittee and the Subcommittee members themselves, perceived the lack of a provision for start-up capital to be the major omission in the enterprise zones concept and legislation. There are a variety of forms of government financing available including Small Business Administration (SBA), Urban Development Action Grants (UDAG), Economic Development Grants (EDA),as well as traditional creditor institution financing and venture capital. Almost none of these methods provide sufficient funds, particularly start-ups, at what small businesses regard as a fair rate while also avoiding unduly burdensome forms and applications.

The small business entrepreneur resents having to give up a share, often a large share, of his business for financing, although this seems to be an accepted mode for venture capital in large business enterprises. This is the origin for the fairly time-honored complaints of the small business entrepreneur that he cannot obtain cheap capital.

The policy issue to be resolved at the various levels of government is whether the public should remedy this omission of economic packaging through the subsidy of "seed money" (meaning low cost or free capital financing as opposed to "venture capital" invested for profit). This could be done through government financing or through privately subsidized funds on a non-profit basis as some communities have done or are doing. If done promiscuously, free or cheap business capital tends to be abused bureaucratically and politically, with unfortunate consequences. The Subcommittee feels that, if done with restraint and prudence, the case for positive government subsidized seed money for business start-ups seems as supportable as the traditional range of general and specific subsidies.

Another feature which the Subcommittee believes should be included in enterprise zones, and which most who appeared before the Subcommittee believe to be very important, is a provision by the Federal Government for the amenities and facilities (in the modern vernacular "infrastructure") needed to develop and support an area. These include roads, sewers, bridges, plant sites, etc. The Subcommittee believes that such provisions are a necessity because the depressed urban areas which will be targeted for enterprise zones will be largely lacking in the infra-structural assets required for successful economic development.

Here in Baltimore operating urban programs such as UDAG and EDA have been utilized effectively to bring about necessary improvements to the infrastructure of underdeveloped areas. Like almost any group of American business people, the Subcommittee believes the time has come for some Federal financial restraint, but it also believes that provision should continue to be made for infrastructural improvements. The Subcommittee feels that these Federal programs, or Federal provisions similar to them, are an essential ingredient of enterprise zones.

Also viewed as vital are general supporting services such as police and fire protection. The Subcommittee believes a commitment to such services is necessary because inherent in the enterprise zones concept is a requirement that businessmen choose to locate in high-risk areas. Without a strong commitment to these support services, the incentives for doing business in enterprise zones will be overshadowed by the risks of doing business in an enterprise zone.

Support services for employees are essential to assist the chronically unemployed in adjusting to a working atmosphere and working conditions. These services include psychiatric counseling, job counseling, skill and job training, alcohol and drug therapy, and day care centers. Without a commitment to these types of services within the zone, the Subcommittee believes that businesses could, in employing large numbers of the chronically unemployed, experience difficulties such as high rates of absenteeism and job turn-over.

The Subcommittee believes that an essential provision of any new enterprise zones legislation is a requirement for municipalities to provide the above described types of support services to businesses (fire and police) and to employees (day care and counseling). Such a required commitment is part of the recently proposed legislation. The Subcommittee hopes the above described support services will be encouraged or required as components of municipal commitment packages.

Small business representatives voiced a need for the provision of ancillary business services which they cannot otherwise easily or at least cheaply obtain. These ancillary business services include accounting assistance, management counseling, legal advice, labor relations advice, etc.

In the case of business services, the Subcommittee feels that the options are not limited to government subsidies. *The private sector seems better qualified by experience and resource to fill the business services needs of small business.* This could be accomplished in many ways, among them requiring or encouraging larger businesses locating in zones to assist a given number of their small business neighbors. As we have outlined earlier, the City Venture Corporation, with a significant infusion of Federal funds, is undertaking a similar initiative in the Park Heights area of Baltimore City.

Enterprise Zones as a New "Urban Policy"

Very little in the way of social and business experimentation is ever completely new and so it is with enterprise zones. Many governments have been aiding in the economic development of specific areas through a variety of subsidies and supports such as tax abatements, tax holidays, cheap or interest-free loans, low cost use of land, and the provision of free or cheap ancillary services. In this context, enterprise zones represent a new, or another, attempt to provide publicly subsidized financial incentives to improve the economic lot of specific urban areas where business has not flourished and where unemployment is widespread.

While some have announced, and some have misperceived, that the enterprise zone concept represents a radically new and complete urban policy to replace all other devices, this certainly is not the case. Even the academic creators of enterprise zones caution that it should be viewed as an experiment, tested as an experiment, and not viewed as a panacea or a complete urban policy. The Subcommittee agrees with this analysis and urges that enterprise zones not be considered *in vacuo* and to the exclusion of the many other worthwhile and perhaps more flexible instruments used in the past such as UDAG, EDA, venture capital, etc.

CONCLUSION

With these cautions, and with the hope that the enterprise zones concept and legislation can be refined and improved, the Enterprise Zone Subcommittee believes that the enactment of enterprise zone legislation may be of some help to the difficult process of making the urban centers of our nation more effective economically in terms of new business and new jobs.

It appears to the Subcommittee that while existing urban programs have positively aided in urban revitalization, they have not made significantly satisfactory inroads in widespread unemployment or economic development. Once again, it is urged that the adoption of the enterprise zone concept be tempered by the realization of its possible limitations.

We believe the Legislation's final form should be simple in terms of comprehension so that the incentives may be clearly understood and evaluated. The enterprise zone law should not be so loaded with benefits and reporting requirements that it becomes a Christmas tree, meaning all things to all people, rather than a simple experiment. We also urge that enterprise zone law and administration not be saddled with onerous or burdensome bureaucracy and paperwork that has bedevilled so many other programs. If entrepreneurs are to be encouraged to take a chance on enterprise zones, so should the government. Flexibility should not be sacrificed to some mythical accounting of public dollars. The Subcommittee recognizes the provisions in the new Urban Jobs and Enterprise Zones Act that would encourage administrative streamlining and ease the regulation burden on businesses. The Subcommittee hopes these provisions will be maintained and strengthened.

The Subcommittee feels the establishment of ten to twenty-five zones per year for three years extends the enterprise zone concept beyond the realm of experimentation into the inventory of proven, operational public policy. The Subcommittee suggests that the refined enterprise zone be established in a limited number of sites not to exceed ten. This limited scale is sufficient to allow due attention to be given to regional differences and allow for careful consideration of the advantages and disadvantages of the concept on an experimental scale. The establishment of only a moderate number of enterprise zones will also ensure that adequate resources will be allocated to zone designated areas. The establishment of enterprise zones on the scale proposed by the new legislation threatens to dilute the resources available to zones and cripple their potential for success.

The Subcommittee is quite familiar with what Baltimore has done in terms of economic development and what remains to be done to cope with its problems of unemployment and underdevelopment. The Subcommittee is also familiar with the City's pioneering in what is in effect an enterprise zone in its Park Heights development, and the City's desire to continue its tradition of aggressive experimentation by becoming an enterprise zone test city. The Enterprise Zone Subcommittee believes that Baltimore should, for these reasons, make an excellent site for the experiment and so recommends. With all of the tools for economic and social development and support in use in Baltimore, the enterprise zone may add still another dimension that may contribute, within the limits set by its proponents.

In sum, the findings and recommendations of the Subcommittee are as follows:

(1) Enterprise Zones should be viewed as an experiment and not more than ten zones should be designated until the concept has been proven effective. Newly proposed legislation would allow up to seventy-five zones to be established. This would thrust enterprise zones well beyond the realm of experimentation.

(2) The enterprise zone by itself does not represent a complete urban policy and will require the assistance of some existing urban programs.

(3) Enterprise zone legislation should not only encourage small business entrepreneurs, but larger business participation in enterprise zones should also be encouraged. A selection mechanism should be established to discourage larger businesses from

moving their plants from other areas to enterprise zones. Only large firms opening new plants should be allowed to operate in zones.

(4) Enterprise zones should be sufficiently flexible to allow for the employment of chronically unemployed people residing within the entire metropolitan area and not from within the zone alone.

(5) Declining industrial areas, and not residential areas alone, should be targeted for enterprise zones designation as is the case in Great Britain.

(6) The tax incentive offered by enterprise zones will not do much to solve the problems of small business development and thus relieve urban unemployment.

(7) Start-up capital is a major omission in the enterprise zone concept and legislation. If done with restraint and prudence, the case for positive government subsidized capital for business start-ups seems as supportable as the traditional range of general and specific subsidies.

(8) Enterprise zones should include Federal provisions for infrastructural improvements.

(9) Adequate support services to businesses (police and fire protection) and employee services (day care and counseling) are required to make enterprise zones successful. These services should be required of municipalities in seeking enterprise zone designations. Cities such as Baltimore believe that

they will not be able to provide the funding for these services without federal financial support.

(10) Needed business services (management counseling, legal advice, labor relations advice, etc.) could be supplied to small business enterprise by larger businesses wishing to take advantage of tax incentives provided in enterprise zones.

(11) The legislation's final form should be simple in terms of comprehension so the incentives may be clearly understood and evaluated.

Some of the above recommendations and views are incorporated in the new Urban Jobs and Enterprise Zone Act of 1981 and will hopefully appear in the bill's final form. Where these suggestions are not part of the new legislation, the Subcommittee urges the legislation be ammended so they may be included.

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PARK CIRCLE

PROTECTIVE COVENANTS

[illegible]

FINANCING

The key to a successful business start in Park Circle is a workable financial package. Money for development is available from diverse sources, including:

☐ Loans through BEDCO Development Corporation under the City's $83 million bank commitment program (NBR), utilizing 90% SBA loan guarantees, or SBA's 503 fixed asset lending program.

☐ Tax—exempt financing through City Industrial Development Revenue Bonds or the Maryland Industrial Development Financing Authority (MIDFA). These loans are for fixed assets only.

☐ Conventional financing through banks, savings and loans and insurance companies.

☐ Urban Development Action Grants (UDAG) for loans to undertake projects that will stimulate economic growth and attract employment and tax base.

BEDCO, the city's economic development corporation, has the staff and experience to work with your business and structure the most advantageous loan package. Loan proceeds can be used for:

☐ Land Acquisition and Improvements

☐ Building Acquisition and Construction

☐ Machinery and Equipment

☐ Renovations

☐ Soft costs: Architecture, Engineering, Legal fees, Appraisal, Survey fees and Accounting

EMPLOYMENT

Recruiting and training personnel is a major time and cost consideration when you open a new plant. That's why at Park Circle there's Job Match. Job Match is a service that will help you cut your costs and find the right people for new jobs. And because it's linked to an available pool of qualified people in the STARTERS Program, Job Match is like having a free employment service for your company. After you specify your employment needs, STARTERS checks them against the qualifications of job ready people in its applicant pool. Suitable candidates are then referred for interviews. If an onsite or off-site training program is required, Job Match negotiates the arrangements for the program.

By hiring certain STARTERS applicants, your business is eligible to qualify for a tax credit of 50 percent of the person's first year's wages (up to $6,000) and 25 percent of the second year's wages (up to $6,000). If you have an approved training program of your own, you may be able to receive a rebate of up to half of the training wages for every trainee hired through STARTERS.

There is a readily availabe labor pool living near Park Circle in the Park Heights community. Through Job Match, residents with the skills and education needed to meet particular labor requirements will be introduced to your business. This assures your company of dependable personnel who will not have to face commuting problems.

JOB TRAINING

When you open a new plant, you'll need to train and familiarize new employees with your operation. You may prefer on-the-job or off-site training during either the plant construction or the business expansion phase. No matter when, all companies are concerned about the cost of training and the time it takes for new personnel to achieve an acceptable level of work productivity.

One of the features of the Job Match system at Park Circle, is to help your company set up the most responsive training program. Job Match can help you provide your own training, or you can be reimbursed for as much as half of the wages paid to eligible trainees. It can also help arrange cost sharing agreements to set up an off-site training program that can duplicate your own production process. Job Match can help your company recruit men and women who have successfully completed skill training programs which relate to new company job needs.

In today's competitive markets, companies need employees to be trained and re-trained to master new technologies. The Park Circle Industrial Park Management recognizes this important factor, and with Job Match, we are able to help your company maintain productivity and profitability.

PARK CIRCLE
INDUSTRIAL PARK

Park Circle Today

Covering 40 acres in northwest Baltimore, The Park Circle Industrial Park is being planned to support the growth of new and expanding companies. Attuned to "bottom line" performance, Park Circle offers the location, financing, and labor packaging necessary to get your business in operation quickly and economically.

Sites are available for sale or lease on terms to meet your needs. All available financing tools, including industrial revenue bonds, industrial shell building loans, mortgage insurance programs, fixed asset and working capital loans can be tailored to meet your needs. Your workforce can be recruited, pre-screened and trained at no cost to you, with your people ready to go to work the day you want to open for business.

Space as well as support services for starting businesses will be available in the Business and Technology Center (BTC). Secretarial, bookkeeping, data processing, management counseling and technical services can be purchased as needed, reducing critical overhead costs and helping make you profitable as quickly as possible.

Our Commitment to You

William Donald Schaefer Mayor, Baltimore City

The Park Circle Industrial Park is being designed and developed with the same imagination and forethought that produced Baltimore's renowned Harborplace and National Aquarium. Mayor William Donald Schaefer is 100% behind this undertaking, and every business in Baltimore knows that Mayor Schaefer means business.

Developed by the Baltimore Economic Development Corporation (BEDCO), one of America's most respected urban development corporations, Park Circle represents Baltimore's commitment to supporting in-town industrial expansion and employment growth. You can count on the city to expedite the processing of all permits, arrange financing, train manpower, and maintain the quality, appearance and security of the industrial park. Park Circle will be managed to ensure that each property is properly maintained and each investment is protected.

City Venture Corporation, a unique management company created by leading American businesses to bring about inner city reinvestment, is coordinating the marketing effort. The Park Heights Development Corporation, a community-based business development and service company, is involved in marketing and property management.

Hiring New People

Job Match makes it easy.

Locating and recruiting good, reliable employees is one of the major problems a new or expanding firm encounters. The hiring process alone can take time and money, and training can be even more costly.

We've anticipated this stumbling block and set up the Job Match program to help businesses locate, screen, hire, train and counsel new employees. Job Match includes customized training to meet specific skill needs, with all costs shared or publicly funded. Support continues beyond your initial staffing process and helps personnel throughout the early months of their employment.

Through the use of these programs, Park Circle businesses will be able to start with pre-trained employees. This training will come at little or no expense to a company and it will help get your business off to a smooth start. This and much more is done to assure your ability to reach full production levels as soon as possible.

Supporting What You Have

The BTC

As a Park Circle Business, you will have access to one of the most complete business support systems available anywhere. Being developed and operated by the Control Data Corporation, the BTC (Business and Technology Center) is designed to help increase the success rate of growing companies of all sizes. It's an economical way to incorporate otherwise expensive, yet necessary, services into day-to-day operations.

The BTC will lease office and industrial space to small companies and provide a full range of business services, including: telephone answering, word processing, accounting, business planning and management assistance. There will also be library facilities and a shared loading dock.

The BTC also offers a full line of computer services including technology location and transfer, and computer-based management education. Use agreements with outside laboratories and test facilities will be set up as necessary. In addition to basic computer service, high technology businesses will be able to benefit from subscription to the TECHNOTEC system. TECHNOTEC is a computerized information exchange system developed by Control Data to facilitate the world-wide transfer of new technological information. This system provides an extensive data base and offers a direct marketing medium for the business with a high tech product.

BTC services will be offered to all Park Circle companies on a fee basis. The Center will be located on Druid Park Drive, providing easy access.

While the BTC was conceived and established primarily to support small Park Circle firms, its shared space and service options present a wealth of possibilities for the creative business person. No matter what your firm's present size, if your plans include growth and expansion or increasing profits and productivity, you will find the BTC to be a very effective resource.

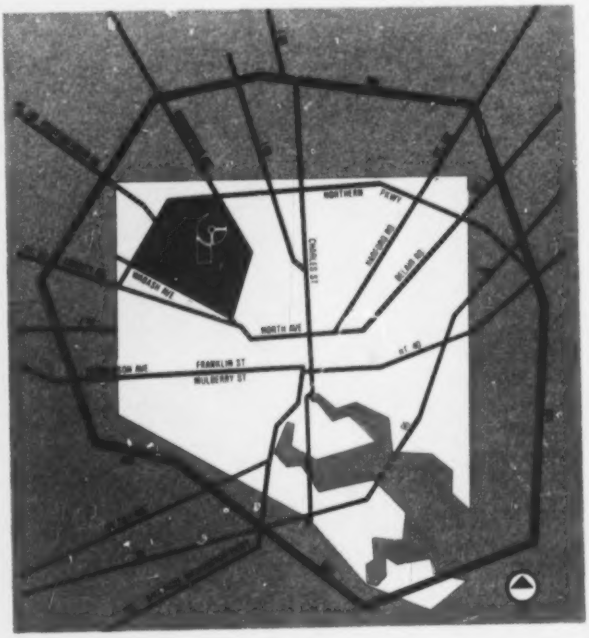
Location

Located only 3.5 miles from downtown Baltimore, Park Circle offers convenience and ready access to its users. Air, rail and truck transport services are close by.

The Baltimore-Washington International Airport is only a half hour away by car and there are several excellent routes serving the Port of Baltimore. Team track rail service is available less than 3 miles away.

Park Circle is accessible by car or truck from several major highways. I-83 via Reisterstown Road and North Avenue. I-695 via Liberty Heights Avenue. I-95 via Monroe Street and Wilkens Avenue. Park Heights and Reisterstown Roads handle the primary north/south traffic, while Cold Spring Lane accommodates the east/west flow. Liberty Heights Avenue and Druid Park Drive also carry a major portion of the local traffic.

Mass transit support for the area includes 5 major bus routes to and from downtown as well as local routes connecting Park Circle with area neighborhoods. Two nearby subway stops are under development and will be opened by 1983.



Site Availability

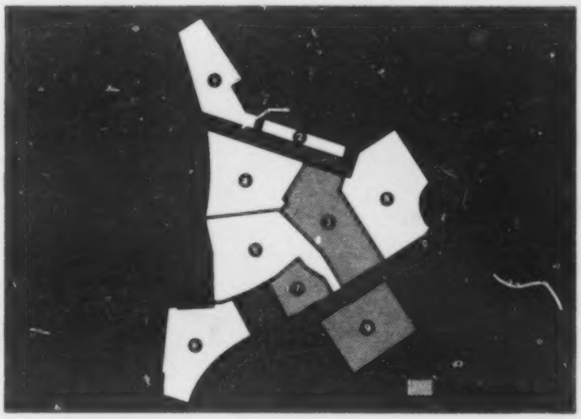
Your Business Community

As a new business in Park Circle, you will be neighbors with corporations like Control Data and its related company, Commercial Credit. The Community College of Baltimore is across the street, as is the C & P Telephone Company and two of the City's loveliest parks.

To reinforce a commitment to making your business start-up costs as reasonable as possible, land will be sold or leased on terms needed to support business growth. This valuable acreage is zoned and equipped to handle light industrial manufacturing. While the BTC (Business and Technology Center) will offer existing space, the majority of the businesses joining the Park will have the option of building their own plants.

All basic utility services will be within easy reach of your property, minimizing hook-up costs. Water, storm drainage, sanitary sewerage, electricity and gas are all available.

Police and fire protection are available within minutes of the Park, as are full medical services provided by the nearby Provident Hospital. Shopping centers, banks and restaurants are located throughout the area.



Guaranteed Compatibility

Park Circle will attract established companies opening branch plants as well as younger companies undergoing major expansion. Your company will be able to select and develop a site that meets your present needs and allows for expansion. Protective covenants will help assure the compatibility of all businesses within Park Circle as well as with the Park Heights community. Along with the covenants, a master plan has been prepared to guide Park Circle's growth and development.

Your Image

Park Circle is one of the newest landmarks of Baltimore's renaissance. As part of the Park, your company will share in the City's recognition of each business' contribution to Baltimore's growth.

Great effort is being made to make Park Circle as attractive as possible. Park Circle's landscaped entrance, design guidelines, and protective covenants have been conceived to showcase your company's operation, enhance your reputation, and insure your investment.

PARKCIRCLE
INDUSTRIAL PARK

City Venture Corporation
5430 Park Heights Avenue
Baltimore, Maryland 21215
Phone (301) 664-1032

BEDCO
36 S. Charles Street
Baltimore, Maryland 21201
Phone (301) 837-9305

Who Could Ask For More?

Furnished as a public service to
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Alexander Grant
& COMPANY
CERTIFIED PUBLIC ACCOUNTANTS
BALTIMORE

Senator HAYAKAWA. We have a vote on.

Senator BOSCHWITZ. Yes. Do you want to go and vote or should we recess? We have two more witnesses, Mr. Paul Pryde—is he here?—and Rev. Leon Sullivan. I do not see him here.

Senator HAYAKAWA. I hear he is on his way.

Senator BOSCHWITZ. Is he on his way?

Once again, Mr. Pryde, we have a vote on.

Do you want to listen to the testimony, or shall we just break?

Senator HAYAKAWA. Let's take a break for a moment and we will go and vote and come back.

If you will excuse us, we will go vote. The clock has given us our orders.

Senator BOSCHWITZ. Your testimony looks interesting. Senator Hayakawa and I would like to hear your testimony so once again we will take a little break and go over and vote.

[Recess taken.]

Senator BOSCHWITZ. We are going to hear from Mr. Paul Pryde of Janus Associates. Mr. Pryde, would you begin?

STATEMENT OF PAUL L. PRYDE, JR., PRESIDENT, JANUS ASSOCIATES, WASHINGTON, D.C.

Mr. PRYDE. Thank you, Senator. I have a prepared statement which I would like inserted into the record.

Senator BOSCHWITZ. Without objection.

Mr. PRYDE. I would just like to summarize briefly the highlights of that statement for you.

As we have heard from several different witnesses this morning, the extent to which small businesses expand and grow and are formed in enterprise zones will largely determine the success of that idea. As we have also heard, there are three principal barriers to their expansion and formation which I think need to be addressed: They are the availability of capital at reasonable cost, the quality of the local environment, and the availability of adequate labor.

I have five suggestions that I would like to make for using the tax system creatively and constructively to increase business formation and expansion rates in enterprise zones. I have three suggestions in what you might call the capital area and one each for improving the neighborhood environment and one for the employment area.

As Dave Birch and several other witnesses pointed out, most startup firms, most new firms, the type most likely to be formed and expanded or located in enterprise zones, get most of their money from friends, family, and associates. Thus, what is needed are incentives for investments by individuals in enterprise zones, that is, incentives which will induce such people to put their personal savings at risk.

I have done some analysis of one such incentive, the reduction or elimination of capital gains taxes, and I find in my analysis that eliminating capital gains taxes which have already been reduced under the Economic Recovery Tax Act, would not be a large inducement to increased investment in enterprise zone firms. Just to do a little bit of arithmetic on that point, if you were to take a

$10,000 investment which tripled its value over 5 years and then was sold, under the current law the aftertax rate of return for a taxpayer in the 50 percent tax bracket would be around 21.5 percent. If you eliminated capital gains taxes entirely, that rate of return would go up to 24.5 percent. I am just not convinced that that margin of difference will be sufficient to induce investors to take on the added perceived costs and risks of investing in enterprise zone firms.

Therefore, as an alternative I would suggest that the treatment of section 1244 stock—and I will go into what I am talking about briefly—be changed to allow investors who purchase such stock to take an ordinary loss deduction in the year in which the investment is made. Under present law, section 1244 stock is common stock issued by a small business corporation with $1 million or less in net worth, including 1244 stock, and that corporation also has to get at least 50 percent of its income from active rather than passive sources.

Current law permits investors to take ordinary loss deductions with respect to that stock if a finding of worthlessness is made. What I am suggesting is, rather than requiring investors to show that stock is worthless at some later date, that that stock be presumed for tax purposes to be worthless in the year in which the investment is made.

I see two benefits from this particular change in the tax law. One is that it would create a safe harbor for investments in enterprise zone 1244 stock, in that the stock would be immediately presumed to be worthless and IRS would not challenge any ordinary loss deductions taken with respect to it.

Second, by moving the date of the loss forward you would increase the value of the ordinary loss deduction. That is, dollars today are worth more than dollars tomorrow.

I have also suggested that enterprise zone companies be allowed to issue the small business participating debenture, the hybrid financing device which would have been created by S. 360, and that the treatment of those small business participating debentures be the same as that which I have recommended——

Senator BOSCHWITZ. Let's stick on your 1244 for a minute because you skipped a portion. You require a holding period.

Mr. PRYDE. Yes.

Senator BOSCHWITZ. I am not quite sure, can the stock in its entirety be deducted as worthless in the first year? Is that the idea?

Mr. PRYDE. That is what I am recommending. That is right. It is not now. You would have to show the IRS that you had made an investment which later became worthless under current law so that the loss would be taken 3, 4, 5 years later. What I am proposing is that you presume that it be worthless immediately.

In my judgment that change will not cost the Treasury very much money. In the worst case, and I have included in testimony a hypothetical example: If you take 10 investors, each of which has gotten $100,000 from an investment group, the worst that could happen to the Treasury is that all the investments fail, in which case what it simply does under my proposal is incur a loss immediately that it would sustain anyway.

A more reasonable case is that at least two of those investments would succeed. I have done a hypothetical analysis, assuming that those two companies do not pay any taxes for 5 years and in the sixth year earn $100,000 income on which they pay taxes, and that their earnings increase by 20 percent every year thereafter. Further assume that the Treasury taxes those firms not at the top margin of the rate but the average rate at which corporations are now taxed, 25 percent.

Under those assumptions, the $500,000 the Treasury would lose in the first year is repaid with a 15-percent rate of return. Therefore, the Treasury makes an investment on which it gets its money back.

Senator BOSCHWITZ. I think Professor Birch or Dr. Butler suggested a 3-year worthlessness, using that term, 3 years right off the investment as an ordinary loss. I suppose that would not be as good in your judgment but nevertheless——

Mr. PRYDE. That the loss be allowed over a 3-year period?

Senator BOSCHWITZ. Yes.

Mr. PRYDE. It would not be as good. I would have to do some analysis to find out how that would affect the investment. By the way, was he talking about the holding period or the rate or the number of years over which the investment could be written off?

Senator BOSCHWITZ. I will have to review it but I believe it was the number of years over which the investment could be written off.

Mr. PRYDE. That would reduce marginally the cost to the Treasury and it would also reduce marginally the cost to the taxpayer. I am not sure what you would get by doing that would be worth it but I am not saying it is not. I just have to do the numbers on it, so to speak.

Senator BOSCHWITZ. I could hear the 1-year affair being attacked as a possible tax shelter, and working out some kind of a dodge that a company somehow works out a method of perhaps avoiding some taxes in that way.

I just wanted to hear your response. Why don't you go on to your next point?

Mr. PRYDE. I also suggested that enterprise zone companies, as I mentioned earlier, be allowed to issue small business paricipating debentures, the hybrid financing instrument that S. 360, the Omnibus Small Business Capital Formation Act, would have authorized, and that the same immediate ordinary loss treatment be allowed for such debentures.

My third recommendation addresses the now controversial leasing rules. While it is true that the safe harbor leasing provides most of its benefits to big companies, the law is potentially useful to small companies which are in their early stage of development and which do not have sufficient income to use all the tax credits and deductions their equipment purchases may entitle them to.

What I would want to recommend is that a couple of changes be made in the leasing rules as those rules are amended to make it easier for smaller companies to gain access to safe harbor leasing. The two recommendations are, one, that the at-risk limitation be changed. Right now the leasing rules make it impossible for closely held companies to become lessors of equipment. That is an inequity which I do not think is warranted or needed or desirable.

Second, the Treasury regulations include a number of events of default which make it almost impossible, because it increases transaction costs inordinately, for smaller companies to sell their equipment tax deductions and credits. I would suggest that that list be dramatically shortened for small companies so that they could take advantage of the law in reasonable fashion.

Senator **Boschwitz**. Would you repeat that, please?

Mr. **Pryde**. Right now the Treasury Department's regulations include a number of events of default which, if they occur, will result in the loss of tax benefits by the lessor or the purchaser of the tax benefits. Those events of default necessitate legal documentation which is enormous in its copiousness and increases the cost of transactions such that small companies are having a great deal of difficulty selling their tax benefits and deductions.

I would just suggest that those disqualifying events be reduced in number so that smaller companies which are in their early stage of growth but need to finance equipment can sell their tax benefits. I have done some analysis that shows it could make a 25-percent difference in your financing costs, and in today's period of high interest rates, that could be substantial.

In the employment area, I think the administration proposal as I have read it, as I understand it, is a very good one in that it would provide deep incentives for hiring and training all workers but especially low-income workers. I would propose, however, that as is the case with equipment tax deductions and credits, small companies in their early stages of growth cannot use their employment tax credits. Labor-intensive firms will not be able to use all the tax credits to which they are entitled.

As an alternative to refundability, which is opposed by various people right now, I would suggest that as is the case with equipment leases or equipment tax deductions and credits, small firms in enterprise zones be allowed to sell and trade their credits. That would also remove the necessity of having those credits all set against payroll taxes, which in this environment is just a nonstarter, I fear, but it would serve the same purpose.

Finally, there has been a lot of talk, and I think well-founded discussion, of the need to improve the environment in which small businesses can grow and be formed. No business is going to go someplace where its workers are either unavailable or afraid to go. The problem is that it is very difficult to use the tax system to provide incentives which will improve that neighborhood environment.

What Federal tax incentives can do, however, is give corporations an inducement to finance or contribute to those neighborhood or other local groups that are working very hard to improve the civil environments in their communities, and several States have already done this. For example, Missouri right now has a 50-percent tax credit which it provides to corporations which make qualifying contributions to neighborhood development activities. The list of qualifying neighborhood development activities in Missouri is lengthening and there is some very creative stuff going on.

Senator **Boschwitz**. Is the other 50 percent allowed as a deduction?

Mr. PRYDE. I think so but I am not exactly sure. The problem is the Federal treatment of the State tax credit. The State tax credit is considered income for Federal tax purposes, so essentially every dollar of State tax credits which is given by a State is taxed at the Federal level. It provides the Federal Government a windfall from a State tax credit. I think for State tax credit programs for contributions to enterprise zone activities, that provision of law should be changed.

Finally, not all States have such State tax credits. Not all States have income taxes so it might be a good idea to consider an across-the-board 25 percent neighborhood tax credit for such contributions made to groups to improve the civil environment.

Those are my suggestions, Senator. I would welcome any questions you might have.

Senator BOSCHWITZ. I find your testimony to be ingenious. It expands on ideas that have been mentioned before and introduces new ideas. We will take a look into the State tax credit. If it creates income then that would be a serious deterrent to what the States are able to do. Perhaps we have to put a provision in the law to exempt this from creating income, a State tax credit of one form or another. Is that income tax credits that you speak of or any State tax credit?

Mr. PRYDE. In the Missouri case it is a credit against corporate income taxes which the corporation then pays Federal taxes on at its corporate rate. Therefore, essentially at today's rate it would be 46 cents of every $1 of tax credit granted by the State.

Senator BOSCHWITZ. Your testimony is very helpful. I see you have an investment analysis chart as an appendix. Could you just describe that briefly?

Mr. PRYDE. Yes. One of the problems, budget considerations drive all policy considerations to a degree, to one degree or another. I understand one of the reasons that some people do not like the investment incentive I propose is that it costs the Treasury too much, so I decided to do an analysis to see what the cost actually would be.

What I did was, I assumed that a group of 10 companies each received $100,000 under the ordinary loss treatment I have proposed, and that eight of the companies failed outright and that two succeeded. Now that is a rather conservative assumption but based on the notion or the evidence that 80 percent of all small businesses fail. Therefore, I said, "All right, let's assume that eight of those firms fail."

We also know that small firms do not pay taxes in their early years so I said, "Let's assume that for 5 years they pay no taxes, the remaining two firms which are still in operation." However, then in the fifth year each firm gets $100,000 worth of income which it claims for tax purposes and that earnings increases by 20 percent a year—that is not a very high rate, by the way—for the remaining 15 years of the 20-year life of the enterprise zone.

Senator BOSCHWITZ. Have you ever been in business.

Mr. PRYDE. Yes.

Senator BOSCHWITZ. That is a pretty good rate, 20 percent.

Mr. PRYDE. However, it is not exorbitantly high. I went back and looked at 10 cases, some pretty good companies around the District, and I found several who have compound earnings growth rates of

40, 50, up to 60 percent, so 20 percent is not exorbitant, especially if you are talking about having eight firms fail. The experience of venture capitalists is that they do not have that high a failure rate; they may have two successes and three or four that just stumble along and never get anywhere. Therefore, my point is simply that 20 percent may be high but it is not optimistically high in many cases.

I have also assumed that the rate of taxation is less than the highest marginal rate for corporations. The highest marginal rate on income levels I have portrayed here is 46 percent. I have assumed 25 percent because I am assuming that, like most people, those corporations will try to reduce their tax liabilities. I have taken the average rate at which corporations are generally taxed right now, 25 percent, actually 25 to 30 percent.

What I have shown here is that the return to the Treasury from its initial $500,000 loss, which I view as an investment and it is portrayed in the third column, discounts back to a 15 percent rate of return. Therefore, it is not a bad investment for the Treasury. In other words, it is not a cost over the term of the enterprise zone. It is actually a money producer.

Senator BOSCHWITZ. Again, I thank you. Your testimony has given us a great deal of food for thought. Sometimes we kind of run into—I do not want to say a stone wall—but we run into opposition from the Department of the Treasury. They look at every possible tax loss as an incursion upon them. Each group claims that they have an idea that if Treasury gives some type of tax credit, refund, tax advantage or deduction, that it will produce more money for the Treasury if they are patient. I think that Treasury may have a certain skepticism, as a polite way of saying it. They have heard that song before and so they take a relatively uniform approach—at least I, in my negotiations with them have run up against a good deal of opposition.

Mr. PRYDE. I have noticed that also.

Senator BOSCHWITZ. In any case, your testimony is new and refreshing and comes up with ingenious ideas, and so it is particularly welcome. We will review all this testimony and see what we should include in our legislation. We have received a good deal of ammunition with which to argue with people in the adminstration who may have a different view than I or than other members of this and the Finance Committee.

We thank you very much, Mr. Pryde. Again, we say that your testimony was particularly helpful.

Mr. PRYDE. Thank you.

[The prepared statement of Mr. Pryde follows:]

THE PREPARED STATEMENT OF PAUL L. PRYDE, JR.

THE USE OF TAX INCENTIVES TO STIMULATE BUSINESS EXPANSION IN ENTERPRISE ZONES

My name is Paul Pryde. I am president of Janus Associates, a development consulting firm which specializes in small business and development finance problems. I want to thank you for the opportunity to present my views on the use of tax incentives to stimulate small business expansion in inner city enterprise zones.

As I am sure you are well aware, research by David Birch at MIT, the National Federation of Independent BUsiness and others has shown that the principal determinants of small business formation and expansion rates in any region or community are:

1. the quality of the local environment -- the extent to which employers and employees feel safe and secure and have access to needed amenities and services;
2. the extent to which capital is available at reasonable cost; and
3. the cost and quality of the work force -- the availability of trained and productive workers.

These studies show also that taxes, particularly income taxes, rank relatively low on almost all lists of important barriers to business expansion. This does not mean, however, that taxes have no role to play in the development process. On the contrary, tax legislation can be used in several ways to spur the small business growth upon which the success of enterprise zones will depend. Let me turn to these now.

Capital Incentives

As I mentioned earlier, much of the research on local and regional development suggests that the availability of capital (both equity and long term debt) plays a major role in the location and expansion decisions of the young businesses which create most new jobs. Similar research shows that, contrary to popular mythology, venture capital firms and government loan programs are not the principal source of risk financing for such firms. Rather, the new firm gets most of its initial capital from the personal savings of the entrepreneur as well as from investments by friends, family members and business associates.

Unfortunately, because of the availability of investment opportunities offering high yields and great safety, relatively few savers are likely to put their money into small, new firms in enterprise zones without being compensated for the added risks and costs of doing so. Though several pending enterprise zone bills attempt to solve this problem by reducing or eliminating capital gains taxes, I believe stronger incentives are needed. A bit of arithmetic will indicate why.

Under the Economic Recovery Tax Act (ERTA) enacted last August, the maximum tax rate on capital gains was reduced from 28% to 20%. This means that on a $10,000 investment held for five years and then sold for triple its original cost, a taxpayer in the 50% bracket would now get an after-tax return of 21.5%, as opposed to 19.5% under the old law. Eliminating capital gains taxes entirely would raise the taxpayer's return only slightly -- to about 24.5%. It seems to me that few people would be willing to make investments in enterprise zones for such a small difference in prospective rates of return. I have three alternative suggestions.

First, purchasers of Section 1244 stock issued by enterprise zone companies should be permitted an immediate "ordinary loss" deduction in the amount of the investment. As you may know. Sec. 1244 stock is common stock issued by a domestic corporation which:

1. has a total net worth not exceeding $1,000,000 (including Section 1244 stock) and
2. obtains at least 50% of its gross receipts from sources other than royalties, rents, dividends, interest, annuities and sales and exchanges of stock.

Current law permits investors in such stock (which later becomes worthless) to treat the loss as an ordinary loss up to a maximum of $50,000 for an individual, and $100,000 for a husband and wife filing jointly. Allowing "qualified Section 1244 stock" (i.e., common stock issued by enterprise zone companies) to be treated as an immediate ordinary loss would offer investors two important benefits:

1. It would create a "safe harbor" for purchasers of "qualified Section 1244 stock." The stock would be presumed, for tax purposes, to be immediately worthless and taxpayers would be assured that the IRS would not challenge ordinary loss deductions taken with respect to it.
2. More importantly, permitting the investment to be taken as loss immediately would substantially increase the value of tax benefits attributable to ordinary loss treatment. That is, the

> taxpayer would realize his tax savings immediately rather than a few years later. Dollars earned or saved today are more valuable than dollars earned or saved tomorrow.

To discourage certain types of tax avoidance abuses, purchases of "qualifying" Section 1244 stock should be subject to a minimum holding period of, say, two years. Proceeds from sales or exchanges during this period would be taxed as ordinary income. (Alternatively, sales or exchanges of qualifying Section 1244 stock within the specified period could subject the taxpayer to the recapture of the amount of the deduction not fully "earned".) In either event, proceeds from the sale or exchange of qualifying stock beyond the minimum holding or recapture period would be taxed at capital gains rates.

As a second proposal in the same vein, I recommend that ordinary loss treatment should also be permitted for the obligations of enterprise zone firms. As one idea, I would suggest that (a) such firms be allowed to issue Small Business Participating Debentures (SBPDs), a hybrid financing instrument which S. 360, the Omnibus Small Business Capital Formation Act, would have created; and (b) that purchasers of these debt instruments be allowed the same deduction as I have proposed for Section 1244 stock.

Allowing the equity and debt issues of enterprise zone firms to be treated as I have suggested would, I believe, constitute a powerful inducement to increased investment in enterprise zone firms. Once again, a bit of arithmetic will help to show why.

You will recall that I estimated that a $10,000 investment which tripled its value in five years would, under current tax law, give a 21.5% after-tax return for a taxpayer in the 50% bracket. The treatment I have recommended for Section 1244 stock would increase that taxpayer's return by over 50%, to 33%.

According immediate loss treatment to SBPDs would also produce dramatic results. A 50% bracket investor who purchased a $10,000, 10 year, 15% SBPD with a 5% profit participation premium from a firm with $100,000 in annual earnings would realize an after-tax rate of over 25% with the preferred treatment I have recommended. Let me now turn to the issue of the cost of these two recommendations.

One argument which may be made against them is that they will cost the Treasury too much. Not true.

Assume, for the moment, that a group of investors decides to invest a total of $1,000,000 in enterprise zone firms through the purchase of Section 1244 stock. The group selects ten different firms and invests $100,000 in each. Under my proposal, the members of the investment group would be entitled to $1,000,000 in ordinary loss deductions on their tax returns for that year, and the Treasury's revenues would be reduced by the amount of the group's tax savings, or $500,000. In reality, however, this $500,000 drop in income should be viewed aseither (a) a cost which would have been incurred anyway or, (b) an investment which will be repaid from future tax revenues. That is, in the worst case -- if all ten firms fail -- the Treasury would simply realize immediately, a revenue loss it would subsequently have sustained anyway. In the more probable -- if not the best -- case, at least two of the ten firms are likely to succeed. Under this circumstance, the Treasury is likely to get its money back with a relatively tidy return. The attached appendix shows that under one conservative set of assumptions the Treasury's direct return can exceed 15%.

My third, and last, proposal for helping growing, yet fragile, enterprise zone firms attract financing from outside sources involves the controversial "qualified leasing" law. The Economic Recovery Tax Act, which I mentioned earlier, liberalized IRS' leasing rules in a way which permits firms with low earnings to sell their equipment tax credits and depreciation deductions.

The new law has been extensively criticized as an expensive and unwarranted subsidy to big business, and several bills to repeal it are now pending. While it is true that large companies have received most of the benefits of "qualified leasing," the new law is potentially of great use to smaller companies. As we know, the small firms which create most jobs generally have very little taxable income in their early years. Thus, any tax credits and accelerated depreciation deductions to which they are entitled can go unutilized. I would suggest that rather than eliminating the new leasing rules, they be modified to make it easier for companies located in enterprise zones to sell unused credits and deductions as a means of raising operating cash and reducing financing costs.

I believe two changes are needed. First, the law should permit closely held corporations to purchase tax credits and deductions from firms located in enterprise zones. This revision would both remove a major inequity and broaden the market for small firms' tax credits and deductions.

Second, the number of events which can result in the loss of tax benefits under a qualified leas should be shortened for firms located in enterprise zones. At present, purchasers of tax credits and deductions stand to lose their benefits if any number of "disqualifying" events occurs. Shortening this list for enterprise zone firms should greatly enhance their ability to sell their tax benefits by reducing the purchaser's risk.

Employment Incentives and Neighborhood Environment

Beyond capital at reasonable prices, the emerging firm requires both an adequately trained work force and a hospitable neighborhood environment -- one which provides both security and needed amenities and services. Few firms will locate where the workers it needs are either unavailable or afraid to go.

The Administration's enterprise zone proposal contains what I believe to be excellent incentives to encourage employers to hire and train new employees, especially low-income workers. Nevertheless, as is the case with equipment tax credits and depreciation deductions, young, low-profit firms may find it impossible to use all of the employment tax credits to which they are entitled. As a means of making these credits useful to low-profit companies, I would suggest that enterprise zone firms be permitted to trade and sell their unused employment tax credits in much the same fashion as is permitted under the new equipment leasing law.

Unfortunately, no set of tax inducements of which I can now think is capable of reducing crime or vandalism or automatically making run-down neighborhoods good places to work and do business. What tax incentives can do, however, is encourage private business to support the activities of neighborhood groups which are doing things to reduce the costs and risks to business.

To encourage just this, some states now give tax credits for corporate contributions to qualified neighborhood activites that contribute to the development process. For example, Missouri gives corporations a 50% credit against state income taxes for community oriented grants. Thus, a company which contributes $100,000 to a neighborhood day care organization can, under Missouri law, reduce its state taxes by $50,000.

Ironically, these credits are taxed at the federal level, thus decreasing their value to corporations and providng the federal government a windfall it doesn't deserve. Eliminating the federal tax on state tax credits should encourage more states to adopt similar tax credit programs and encourage greater giving on the part of corporations. While this proposal will encourage states which do not now have tax credit programs to adopt them, it is also desirable to encourage corporate grants to desirable development activities in states with no income tax. I, therefore suggest a federal credit of 25% of any contribution made by corporations to qualifying neighborhood development activites in states where there is no income tax.

Mr. Chairman, I believe as you do that well-designed enterprise zone legislation can play an important role in promoting increased economic activity in distressed urban neighborhoods. I hope the suggestions I have made will help you in your efforts to craft such a bill.

Thank you.

APPENDIX

Investment Analysis

Qualified Section 1244 Stock

Year	Combined Earnings	Treasury Return (Investment)
1	0	(500,000)
2	0	-
3	0	-
4	0	-
5	0	-
6	200,000	50.000
7	240,000	60,000
8	288,000	72,000
9	346,000	86,000
10	415,000	104,000
11	498,000	124,000
12	597,000	149,000
13	717,000	179,000
14	860,000	215,000
15	1,032,000	258,000
16	1,238,000	310,000
17	1,486,000	372,000
18	1,783,000	446,000
19	2,140,000	535,000
20	2,568,000	642,000

Discounted rate of return 15.1%.

Notes to Appendix

The above analysis assumes:

(a) the two successful companies have no taxable income for five years;

(b) in the sixth year, each company reports taxable income of $100,000, or $200,000 for the two firms combined;

(c) in each succeeding year, earnings grow by 20% and are taxed at an average of 25%.

Senator BOSCHWITZ. We are unfortunate that Reverend Leon Sullivan is unable to be with us, so we are going to enter into the record the entirety of his testimony.

Reverend Sullivan has a long history of successes. He has them in Minnesota as well as in Philadelphia. I have been active in the so-called TCOIC, which is the Twin Cities Opportunities Investment Corp. We have met with some successes up there and I know that he has met with successes in the rest of the country.

Indeed, his successes have reached far and wide, including South Africa where through an initiation of a very statesmanlike approach to what American companies should do who operate in South Africa and how they should treat all of their employees, without regard to race or creed or color. He has, I think, achieved some remarkable things in South Africa—not only, interestingly, among the American companies located there but among the African countries who have emulated some of the successes found with the Americans who operate there.

Therefore, we are sorry that Reverend Sullivan cannot be with us this morning. If we have more hearings, we will invite him back because I recognize the value he would bring to these proceedings.

[The prepared statement of Reverend Sullivan follows:]

THE PREPARED STATEMENT OF REVEREND LEON H. SULLIVAN

Mr. Chairman:

My name is Leon Sullivan. I welcome the opportunity to appear before you today to share with you my views on the issue of small business investment in enterprise zones.

I am especially aware, Senator Boschwitz, of your advocacy for enterprise zones development in the United States as demonstrated by your introduction of Senate Bill 1310, a Senate version of the Kemp-Garcia Bill in the House.

Most recently, the National Executive Director of OIC (Opportunities Industrialization Centers) returned from England, where he had an opportunity to observe their enterprise zones in operation. He indicated that there is a real potential for revitalization of the metropolitan inner-city neighborhoods if we can learn from the mistakes of the British.

In addition, I have had several talks with Congressman Jack Kemp, whose convictions and earnest efforts concerning enterprise zones have earned positive commendation from a broad cross-section of American leaders in business and government ranging from a President, Ronald Reagan, on the conservative side, to a Congressman, Augustus F. Hawkins, on the liberal side.

My own Congressman, William Gray of Philadelphia, is a co-sponsor of the Enterprise Zones Bill in the House, and he, along with Congressman Bob Garcia of New York, recently joined Jack Kemp in co-sponsoring a bill to assure job-training components and the participation of small businesses and minority businesses in any enterprise zones that are created. This Bill, H.R.3824, has the support of a broad coalition of community-based organizations, including the National Urban League, the National Puerto Rican Forum, the National Council of La Raza, Operation SER, and the National Council of Negro Women.

A Senate Bill, S.1797, introduced by Senator Howard Baker for Senator Bob Dole and the Chairman of this Committee, Senator Lowell Weicker, is basically a bill to protect community-based organizations of demonstrated effectiveness in targeted job training. It guarantees their participation in training residents in the enterprise zone so that they can fill the jobs that are created. In addition, it states categorically and unequivocally that small businesses must be guaranteed participation.

It is this last provision, Mr. Chairman, that has led me to come before you today to testify on behalf of those who would urge your Committee to seek legislative authorization for government incentives that would encourage small business and minority business owners to participate in enterprise zones.

As you probably know, the initial concept and thrust of the Kemp-Garcia initiative was focused on tax incentives and tax credits to businesses which establish operations and create jobs in the zones that are established. To small businesses and most minority businesses, this was discouraging rather than encouraging because it didn't do them that much good. Also, they regard the advantages to businesses outside the zones. There was not provision for seed capital to enable a small business to start up or expand. There was no provision to encourage the existing auto repair shops, shoe shops, drug store owners, and other small income-producing businesses already located in a neighborhood. The fear prevailed that the giants, the big businesses, would come in and take over with what would amount to a small business removal program.

I must confess, Mr. Chairman, that I was one of them. You could count me among the protestors. I said as loudly as possible in press and pulpit that we did not want and would not have any enterprise zones in our neighborhoods unless there were built-in assurances of job training and small and minority business participation.

It is a matter of history now that this concern and this skepticism about enterprise zones is what led us to urge the drafting of a provision to include us in rather than count us out if the passage of zones legislation become a reality.

The alarm among the businessmen in my community in Philadelphia and my own (as Chairman of the Board of a small manufacturing business called Progress Products) was matched by the outcry in the other 125 cities in 44 states where I have OIC operations.

Therefore, Mr. Chairman, I come before you today, not just as a single businessman, but as a representative of colleagues across the nation. I come to say to you that we are pleased to find in the Chairman of the Small Business Committee, Senator Lowell Weicker of Connecticut, a champion for the cause of the small businessman and community-based organizations.

We are pleased to find him stressing investment in human capital as well as in the money market capital.

We are encouraged by his emphasis not only on the human side with job training but also on the community participation side with small businessmen.

We look with favor upon his firm and positive affirmation that has helped his colleagues on this Committee and in the United States Senate to realize that some of the most valuable resources to the nation are its human resources and that the most invaluable and essential element in a successful national economic recovery program or community economic revitalization program must be the small businesses of America that create more than 80% of the jobs.

Mr. Chairman, in these days when the average working man in America is asking, "Will I be replaced in my job by a robot, or will a computer put my boss out of business?" it is terribly important to design and develop a national employment and training policy integrated with a national small business development policy. It is terribly important to help the Congress and the White House understand that it is a necessity and not a luxury -- an investment that will pay dividends, not a hand-out to put federal money into capital formation and to make seed capital available to small businesses.

Such incentives will deal with the fundamental problems that have resulted in so many minority business failures.

Such federal government underwriting of financial success and capitalizing will help those who want to make the free enterprise system work.

In our own aerospace factory, for example, when General Motors withdrew subcontracts that it had made available because they could not afford to continue, the only resource that would make it possible for us to make it would be the (8A) provisions to encourage minority business development.

Mr. Chairman, I guess that the bottom line for me this morning has to be an expression of gratitude to you for your leadership along with Senator Weicker in raising the level of consciousness of your colleagues in the Senate as to the potential value of enterprise zones and the ways in which those zones can be made successful if adequate provision is made for successful, profitable small businesses to develop and expand within the zone.

With a recession in progress, with profitability eroding, with an unemployed workforce fearfully anticipating technological obsolescence, it might seem reasonable to ask, "Why do we presume to make long-range plans to rebuild and recover and revitalize the distressed areas in the nation?" I say we have no choice. We can't turn back and give up. We must invest in our people, invest in our small business owners, invest in America.

We must influence our major industries to give subcontracts and even three-year to five-year continuing contracts to small businesses in targeted and distressed areas such as enterprise zones. The National Federation of Independent Businesses and the National Small Business Association must be supported in their efforts.

An alliance between community-based training organizations and small businesses affords a great potential for cooperative planning and carrying-out of plans on a community-by-community basis.

For I am convinced that enterprise zones cannot be successful without community-based organizations to train the zone residents in marketable skills so that they can be hired to fill jobs created in the zones.

I am further convinced that programs like U.D.A.G. (Urban Development Action Grants) and Economic Development Administration loans find it hard to reach down to the level of small businesses. Therefore, there is a need for a tax incentive approach. Targeted tax credits can accomplish much that cannot be accomplished in any other way. I believe that if we can improve our methods of working with small businesses, simplify the regulations and guidelines, and in some instances eliminate the negative and accentuate the positive, we could help small businesses survive and thrive. They can in turn make a tremendous contribution to the enterprise zones if and when they are created.

Since small businessmen and women pay individual taxes, they wind up paying a higher rate than corporate taxes. Since they have payroll taxes at a higher tax rate, some new incentives to relieve the small businessman's specific and unique tax burden would be welcome.

In fact, when it comes to minority business and small business, the recent Ford Company agreement with UAW might well be examined to see what the implications are.

If this is the wave of the future, then the provision not to "contract out" but to bring everything "in house" may eliminate small businesses whose lives depend on sub-contracts related to big manufacturers in major industries like the automobile industry. Either the federal government or the big companies have been "the market" for small businesses.

Government regulations that strangle small businesses need to be loosened rather than tightened.

Government regulations which assume that small businesses do not need federal undergirding by provisions for an (8A) category or provisions for remaining in that category until they make their way through the minefields into the American economic mainstream need to be rewritten.

I believe, Mr. Chairman, that a creative and imaginative approach has been suggested by Mr. Thomasetti, a vice president of General Electric, who has developed what I call the Thomasetti Plan. (Describe -- see appendix.)

This plan has been tested in our own plant and industrial park, and we believe it can be made to work for the benefit of small businesses in enterprise zones.

Finally may I say to you that your influence as members of the Senate Small Business Committee should not be underestimated. We need your voice speaking out for the investment of human capital as well as stocks and bonds. We need your leadership in a drive to make certain that significant changes are made in enterprise zones legislation that is currently before the Finance Committee so that small businesses will be able to enthusiastically participate and community-based training organizations will be able to mobilize broad community support and participation.

The federal government should give incentives to the local government so that it will plan to lower the regulations and provide security safeguards and city services that will encourage small business development.

Put another way, this enterprise zone experiment is of necessity an intergovernmental project and the federal legislation that passes must anticipate and protect local initiative and local self-determination. If it is the only train going out of the station, we want to be sure that community-based organizations and small businesses are on it.

Senator BOSCHWITZ. This hearing is adjourned.

[Whereupon, at 12:25 p.m., the committee recessed, to reconvene at the call of the Chair.]

INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

MONDAY, APRIL 5, 1982

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Oakland, Calif.

The committee met, pursuant to notice, at 9:30 a.m., in Oakland, Calif., Hon. S. I. Hayakawa, acting chairman, presiding.

Present: Senator Hayakawa.

Also present: Robert M. Wilson, counsel; and Brian Kidney, office of Senator Hayakawa.

Senator HAYAKAWA. The hearing of the Senate Committee on Small Business will please come to order.

I would like to welcome the distinguished and able witnesses to this, the first field hearing, of the Senate Committee on Small Business on the topic of "Influencing Small Business Investment in Enterprise Zones."

I would also like to thank them for appearing this morning to share their views with us on this subject.

The concept of enterprize zones has had a lot of publicity since first introduced in 1978 by Sir Geoffrey Howe in Great Britain. Great Britain adopted legislation establishing 11 zones and is currently implementing the plan. As you can see, since it was introduced in 1978 the plan hasn't been going for very long and so there is not very much to be said about its failure or success as of yet.

In the 96th Congress Representatives Kemp and Garcia, along with Senators Boschwitz and Chafee, introduced legislation to create similar zones in the United States. That legislation has been reintroduced in slightly revised form in the 97th Congress most recently and the Reagan administration has sent to Congress its proposal to create 75 of these experimental zones.

As an aside, I might add that I'm an original cosponsor of both the Boschwitz/Chafee bill, S. 1310, and the administration's proposal, S. 2296.

Now, such attention illustrates that the idea is relatively new and yet has been embraced by the policymakers of our governments as a means of restoring economic vigor to our depressed cities and rural areas.

For this reason, the notion is no different from current approaches that it might just work, and those who have embraced the idea are really very optimistic about it, although, as it will appear in the hearing this morning, there are difficulties with it.

Historically, the Federal Government has attempted to solve the problems of urban blight, rural depression, and poverty in general through a massive infusion of government resources into the area.

Unfortunately, these well-meaning attempts to curb poverty have not significantly improved the standards of living of the poor and perhaps have added to the problem.

The underlying assumption of the enterprise zone concept is that the governments of the past have been at the very least ineffective and at worst detrimental to economic development.

Thus, the fundamental premise of the enterprise zone concept is that individuals and businesses can generate and prosper better without Government intervention than with it.

The creation of enterprise zones attempts to foster an unemcumbered area of free enterprise. This is a very interesting idea coming from Great Britain, which has been more heavily socialized than we have by far. It is hoped that when conditions are provided to encourage business growth, the jobs created by the new and expanded businesses will uplift the depressed residents of the zone and the results will be a vital area of commerce rather than a decayed center of unemployment.

Both the primary Federal enterprise zone proposals offer tax incentives, the major component to encourage business participation. The administration's proposal provides a number of targeted tax credits designed to stimulate construction and rehabilitation of zone property and employment zone residents. The Boschwitz/Chafee bill offers a slightly different group of credits, most notably refundable credit for the employment of zone residents who are CETA eligible. In addition, both proposals exempt zone properties from capital gains taxes to encourage investment in zone businesses.

Finally, the proposals both require substantial State and local participation and commitment in establishing and maintaining the zone, with competition among applying areas for designation based upon the merits of their contribution.

I will include fact sheets on each of these proposals for the hearing record at this point.

[Material follows:]

THE WHITE HOUSE

Office of the Press Secretary

Tuesday, March 23, 1982

The Administration's Enterprise Zone Proposal

FACT SHEET

Objectives. The Administration proposes the creation of an Enterprise Zone program, which would [illegible] an experimental, free-market initiative for dealing with economic distress in inner cities and rural towns. Its objectives are twofold:

- To create jobs in the nation's depressed urban areas and rural towns, particularly jobs for disadvantaged workers.
- To redevelop and revitalize the geographic zone areas themselves.

Concepts. The underlying concept of Enterprise Zones is to create a free-market environment in depressed areas through relief from taxes, regulations and other government burdens, privatization of some city services and involvement of private, neighborhood organizations. Because the program is based on the concept of removing government burdens rather than providing government subsidies, it should involve no appropriations, at least at the Federal level.

- The removal of these burdens will create and expand economic opportunity within the zones, allowing private-sector firms and entrepreneurs to create jobs and expand economic activity within these areas. This would be similar to the free trade zones established in other parts of the world, such as Hong Kong, which have been quite successful in stimulating the development of poor areas.

- The program is intended primarily to stimulate new economic activity within the zones that would not otherwise have occurred at all, anywhere, rather than to encourage existing outside activity to relocate into the zones. In addition, the intent behind the program is not to stimulate a particular kind of business, but rather to let the market decide what activities should take place in the zones. While the Federal tax incentives are skewed towards labor-intensive businesses and jobs for disadvantaged workers, the program generally is meant to include a relatively balanced set of incentives for a broad range of economic activities and businesses.

Program Structure. The Federal legislation would establish what areas would be eligible to be declared Enterprise Zones based on criteria concerning poverty, unemployment and other indicators of distress. But this would not be an entitlement program, and, consequently, eligible areas would not automatically become Enterprise Zones. Rather, an eligible area would first have to be nominated by the local government, followed by confirming nomination by the State government, or nominated by the State government, followed by confirming nomination by the local government. Both the nominating State and local governments would then have to apply to the Secretary of Housing and Urban Development for Federal designation. In general, any jurisdiction satisfying minimum population requirements which is eligible under the UDAG program would be eligible for State and local nomination if it met the distress criteria.

- The Secretary of Housing and Urban Development would then evaluate the zone nomination on a competitive basis. The primary criteria for choosing which proposed zones will receive Federal designation will be the quality and strength of the incentives to be contributed by the State and local governments. Particular emphasis would be given to incentives and contributions consistent with the overall Enterprise Zone theme of creating an open market environment through the removal of government burdens. These contributions would include tax relief, regulatory relief, increase in the level or efficiency of local services through possible experimentation with private sector providers of public services, and involvement in the program of neighborhood and community groups. Other contributions and factors would also be considered in this competition.

- A maximum of 25 zones would be approved in each of the first three years of the program. Each zone would last for the period chosen by the designating State and local governments, with a maximum of 20 years on the Federal participation, plus a four-year phaseout of that participation. The Department of Housing and Urban Development would be the agency administering the program.

Federal Tax Incentives. The major features of the Federal tax package are:

- a nonrefundable investment tax credit for capital investments in an Enterprise Zone. For personal property, such as machinery or equipment, this credit would be 3 or 5 percent. For the construction or rehabilitation of commercial, industry or rental housing structures within a zone, the credit would be 10 percent.
- a nonrefundable, 10 percent income tax credit to employers for payroll paid to qualified zone employees in excess of payroll paid to such employees in the year prior to zone designation.
- a special, strengthened, nonrefundable, 50 percent income tax credit to employers for wages paid to zone employees who were disadvantaged individuals when hired.
- a nonrefundable, 5 percent income tax credit to qualified zone employees for wages earned in zone employment.
- the elimination of capital gains taxes within the zones.
- the designation of suitable Enterprise Zone areas as Foreign Trade Zones, providing relief from tariffs and import duties.
- the continued availablity of Industrial Development Bonds to small businesses in Enterprise Zones even if the availability of such bonds is terminated elsewhere.
- any Enterprise Zone firm would be allowed an operating loss carryover for the life of the zone in which it is located or 15 years, whichever is longer.
- any Enterprise Zone firm would be allowed a carryover of any unused employment tax credits for the life of the zone in which it is located or 15 years, whichever is longer.

Cost and Effect of the Tax Package

- o The Treasury Department estimates that the cost of a sample Enterprise Zone which includes 10,000 employees with this tax package would be $12.4 million per year in terms of foregone tax revenue. The cost of 10 such Enterprise Zones in the first year of the program would, therefore be $124 million. The cost of 25 such Enterprise Zones in the first year would be $310 million. The total cost of the program would increase commensurately in future years for increased numbers of zones.

- o As a whole, the effect of this tax package for most Enterprise Zone firms would be to eliminate 75 percent or more of the corporate income tax, eliminate entirely the capital gains tax, provide relief from tariffs and duties wherever Enterprise Zones are also Foreign Trade Zones, and provide income tax relief to the firm's qualified employees. These incentives will facilitate easier access to start-up capital.

Federal Regulatory Relief. Under the Administration proposal, Federal regulatory bodies (all agencies covered by the Administrative Procedures Act) would be given discretionary authority to relax or eliminate their nonstatutory regulatory requirements within Enterprise Zones, in accordance with standards promulgated by Congress, but only upon the request of the State and local governments.

- o To utilize this authority, the State and local governments governing each zone would initially ask Federal regulatory bodies to relax or eliminate particular regulations within the zone. The Federal bodies that promulgated the regulations would have the statutory power to grant such requires at their discretion. Congressionally mandated standards would dictate how the agencies would use this discretion. the standards would include an instruction to each body to weigh the special job creation and economic revitalization purposes of the zones against other important aspects of the public welfare, which may underlie the regulation, and to relax or eliminate each particular regulation within a zone when appropriate. A Federal regulatory body would have no authority to take any action without a prior request from both the State and local governments governing each zone.

- Regulations which are specifically imposed and spelled out by statute would not be affected by this authority. The minimum wage law, for example, would not be affected, since the statute expressly requires that a minimum of $3.35 an hour be paid. The authority could only be used to relax regulations where agencies now have some discretion. Regulations affecting civil rights or whose relaxation would harm the public safety or health, including environmental health, would be expressly exempted from this authority.

State and Local Government Role. The Enterprise Zone program is not simply a Federal Government effort. To be successful, the program must have substantial contributions from State and local governments. In fact, State and local contributions would probably make the critical difference in whether a zone succeeds or fails.

- The initial importance of the State and local contributions is that they would determine what designated zones would be Federally approved. The Federal posture towards these contributions would be highly flexible. No particular element or tax relief or regulatory relief, or any other possible contribution would be required.

  Failure to include one element in a State and local package of contributions could be offset by greater strength in the other elements. It should be remembered, however, that each State and local contribution package would be competitively evaluated against the other State and local packages.

  - In the area of tax relief, State and local governments could provide reductions in State and local income taxes, property taxes, sales taxes, and other taxes which vary among the jurisdictions.

  - State and local deregulation could be provided in such areas as zoning, occupational licensure laws, usury laws, price controls, permit requirements, central planning regulations and building codes.

  - In the area of service improvement, "contracting out" or "privatization" could be one means of improving local services.

  - State and local governments may also provide funding for projects which contribute to economic development in a zone, such as job-training or infrastructure efforts. These governments may use their Community Development Block Grants, Urban Development Action Grants or Revenue Sharing funds for these efforts.

- To encourage local community involvement, State and local governments could provide for the creation of "Neighborhood Enterprise Associations" by zone residents. These Associations could undertake the provision of some city services in their areas, help local residents to participate in the economic success of the zones, particularly through mechanisms providing for equity participation by zone residents, and support volunteer, self-help efforts for the zone areas. Participation in the program by other private sector organizations which could perform these functions could also be encouraged by the State and local governments.

FACT SHEET
URBAN JOBS ENTERPRISE ZONE ACT

A. AREA REQUIREMENTS

1. Area's population must be at least 4,000 if located within Standard Metropolitan Statistical Area of at least 50,000; area population must be 2,500 for other areas. Indian reservations are exempt from the population requirements.

2. Area must be UDAG (including pockets-of-poverty) eligible

3. Area must meet one of the following criteria:

   a. unemployment over last 18 months was at least 1 1/2 times the national average;
   b. was a low-income poverty area as determined by most recent census;
   c. 70% of residents have income below 80% of the area median income;
   d. population decline of at least 10% between 1970 and 1980 and either chronic abandonment of buildings or substantial tax arrearages.

4. Must submit a plan to HUD detailing local efforts to reduce various burdens borne by employers and employees.

B. DESIGNATION BY HUD

1. 10 to 25 zones per year

2. Preference will be given to areas showing the greatest distress, which have the greatest community support and which submit the best plans (including economic incentives given by state, county and local governments).

C. BENEFITS AVAILABLE TO BUSINESS AND INVESTORS IN IT

1. 5% refundable tax credit for wages paid to CETA - eligible (Title II B or D, or Title IV A or B) employees who work in zone.

2. Elimination of the capital gains tax for all the new businesses and investors in them.

3. A package of local tax benefits as designed by each area when they bid to get Enterprise Zone designation.

D. ADDITIONAL BENEFITS AVAILABLE TO THOSE BUSINESSES WITH AT LEAST 40% CETA-ELIGIBLE EMPLOYEES

1. Elimination of income tax on half of all income earned from operations within the zone or interest on loans to zone businesses.

2. May use cash accounting if receipts are less than $2 million per year.

3. Extension of loss carryover to 20 years.

E. BENEFITS AVAILABLE TO EMPLOYEES

1. If employed in the zone by a business with at least 40% CETA-eligible employees, a 5% refundable tax credit for wages earned, up to a $1,500 credit per year.

Senator HAYAKAWA. I should emphasize, ladies and gentlemen, that the purpose of this hearing is not to focus on specific legislative proposals, but to concentrate on small business participation in enterprise zones.

I mentioned the kinds of incentives offered in the major Federal proposals to establish a frame of reference. There has been some criticism of these proposals, that they do not offer small businesses the kinds of incentives necessary to operate in a distressed area.

I hope this hearing will give us a better insight into the needs of small businesses and what we in the Congress could do to meet those needs.

I have the great pleasure now to introduce the Honorable Lionel J. Wilson, major of the city of Oakland.

STATEMENT OF HON. LIONEL J. WILSON, MAYOR, CITY OF OAKLAND, OAKLAND, CALIF.

Mayor WILSON. Good morning, Senator.

Senator HAYAKAWA. Who will favor us with his remarks. My welcome, Major.

Mayor WILSON. Thank you, Senator, First, let me say that I want to thank you on behalf of our city and the committee for holding this hearing on enterprise zones in Oakland.

This city, with its high unemployment and poverty levels and aggressive economic development program under my administration, we feel is an ideal place to test the enterprise zone concept.

Before getting into the presentation itself, with your approval, Senator, I would like to introduce our economic development director, George Williams, who is here.

Senator HAYAKAWA. Mr. Williams, good morning, sir.

Mayor WILSON. Mr. Bangsberg, who is project director for the development project. I believe we have Ton Bane here, who is a part of the economic development department; Councilman Frank Ogawa, who is a senior councilman, very active in this field, he is here with us, Senator.

We have Rusty Jackson from my staff who has been doing some work for us on it, and we are very appreciative to have this opportunity to appear before your committee this morning.

I am very pleased to have been asked to testify before this committee on the topic of influencing small business investment in enterprise zones.

The city of Oakland has closely followed the proposed Federal and State legislation on enterprise zones since 1980. In 1981 the city formed an enterprise zone task force, comprised of representatives from the business and residential communities and the public sector in Oakland, to pursue an enterprise zone in Oakland.

Only last month the Oakland City Council instructed staff to take those actions needed in preparation of an application for enterprise zone status when Federal legislation is enacted.

We in Oakland see the potentials for enterprise zones to contribute to the creation of jobs for zone residents and the revitalization of depressed areas.

We are also aware of the tremendous importance of small businesses to Oakland's economy and of the need to facilitate the establishment and expansion of such businesses in the city.

The zone proposals must be expanded beyond the currently envisioned tax relief and deregulation thrust. There are a number of support activities which are necessary to make an enterprise zone work in our cities, where small to medium-sized businesses are the backbone of the job generation process.

If enterprise zones are to be effective, resources must be available to address the needs of small to medium-sized businesses.

These are: One, working capital; two, affordable land and plant; and, three, a trained work force.

In highly urbanized areas, the needs for land will probably require a land assembly program for new business location and expansion of existing businesses. In these areas, vacant land for development is at a premium.

In some cases, land assembly can be accomplished by the private sector. In others, public assistance will be needed due to the high cost of central city land and the need to use eminent domain powers to assemble sites.

The enterprise zone concept, as currently structured, does not provide for land availability at affordable prices. Needs for capital will require loan programs for inventory, working capital, building development and building rehabilitation.

Loans plus prime or two or higher will provide little assistance. The use of industrial development bonds and urban development action grants for new and expanded development are critical.

Particularly important for new businesses is working capital at the front end. The tax credits available in an enterprise zone would not meet this need. The carryover of tax credits to future, profitable years, while desirable, does not meet the needs for front-end money.

Meeting the labor needs of business will require job training and placement. Tax credits will be inadequate to meet the needs for skills enhancement, particularly for small businesses lacking the resources to provide training.

The administration's enterprise zone proposal would offer tax credits for hiring disadvantaged workers, with the assumption that training would be provided by the businesses claiming the tax credits.

Persons to be trained, however, must be job ready, and other programs are necessary to meet this need.

In addition, to make enterprise zones attractive for development, funds and programs are needed to provide public infrastructure, transportation, environmental improvements, marketing and promotion, housing.

You cannot look to cities to provide those types of improvements.

The financial capacity is not there, and the financial situation at the State level is rapidly deteriorating.

The Federal Government must remain a resource for carefully targeted funds if enterprise zones are to be effective.

Existing Federal support programs have been extremely effective in Oakland's economic development efforts. The city has received almost $20 million in UDAG's, which will create in more than $90 million in new development and create approximately 1,000 new jobs.

The convention center/hotel project is being assisted by a $13 million UDAG. That project alone will generate an estimated 540 new jobs.

Federal loan programs such as SBA-502/503 and SBA-7A have provided needed support to small businesses in their expansion and upgrading activities.

A total of 43 such loans have been approved in Oakland, for a total loan value of $10.5 million. These loans have created or retained more than 700 jobs.

Oakland is also participating in the HUD section 108 program, which has outstanding potentials for success in Oakland.

Oakland's CETA program has been successful in providing employment and training to low-income youth and adults. In fiscal year 1981 the city's program served 4,575 such individuals through vocational and remedial education, work experience, career exploration, and on-the-job training.

Sixty percent of the adult participants were placed in employment, with the majority attaining jobs in the private sector.

The above programs need to be augmented rather than merely focused in enterprise zones.

In addition, industrial development bonds [IDB's] have the potential to stimulate new economic development in Oakland. The city has identified 13 projects where IDB's could be used.

Three of these are within a potential enterprise zone area. The Federal administration apparently realizes the importance of IDB's, since its enterprise zone proposal would allow the use of IDB's in enterprise zones, even if prohibited elsewhere.

The city of Oakland, working with the enterprise zone task force, is currently identifying a specific geographic area in Oakland for designation as an enterprise zone. The current Federal criteria for designation stresses selecting an area of need, rather than an area of development opportunity.

Such criteria as the degree of poverty and level of unemployment exemplify this emphasis.

Those areas of the city with the highest level of poverty, unemployment and stress may not, however, be those with the greatest opportunity for new development If the enterprise zone is to be a success, the area of greatest opportunity, which also satisfies appropriate need criteria, should be designated.

Consequently, opportunities for expansion and new development should be one of the factors influencing HUD's evaluation of applications for zone designation.

In conclusion, the enterprise zone concept must be expanded beyond tax incentives and deregulation. Resources must be available to address the basic needs of the small to medium-sized business, which are land, labor, and capital.

In the event that during the course of the hearings there are any questions between my staff and myself, we would be happy to try and answer any such questions.

Senator HAYAKAWA. Well, I am delighted to hear your distinction between the current Federal criteria for designation of enterprise zones, selecting areas of need or social disintegration rather than selecting those areas of the city with the highest level of opportunity for success.

That seems a very important one. The area with the need and the area with the potential for success may not be the same areas.

Mayor **WILSON**. That's right.

Senator **HAYAKAWA**. In your view, what should be the main goal of enterprise zone legislation; that is, urban renewal, increasing employment, stimulating new business, or all of these?

Mayor **WILSON**. Well, I think all of them are related, Senator. I believe that the primary emphasis in an urban city such as Oakland where unemployment, particularly where you have a city with an ethnic minority of over 60 percent and a black population of 40 or 45 percent, a city in which, although our overall unemployment is not significantly higher than the national rate of unemployment, but if you take young people between the ages of, say 17 and their late twenties, among the overall ethnic minorities you find that unemployment runs at 25 to 30 percent.

If you take young blacks in the same area in our city, you will find it runs almost one out of every two, so it seems to me that it is critical that we emphasize job development.

But in order to provide jobs, you have to provide an economic base with which to provide those jobs.

Senator **HAYAKAWA**. You say that unemployment among young blacks comes to almost one out of two?

Mayor **WILSON**. Yes.

Senator **HAYAKAWA**. I have heard that figure in other cities, too.

Mayor **WILSON**. I have read that figure being similar in some of the other urban cities of America also.

It seems to me, too, that this is an area that has long been overlooked and it is not a matter of partisanship by any means because over the past years we have seen a failure to recognize in this Nation the tremendous need, but also the great hazard that this situation holds for our Nation.

Over 2 years ago two of the most prestigious national business magazines, each in reviewing this problem of unemployment among young people in our major urban cities, spoke along the same veins.

One of them said, saying that this Nation stands on the crumbling edge of disaster around this very problem, and the other one said something substantially the same. These were conservative business magazines analyzing this problem.

Last year we saw what happened in Britain where around the same type of circumstances the riots and the devestation, the property damage as well as human deterioration, was caused by this problem.

If and when it comes to this Nation, and I think unless we deal with it and we deal with it soon, it will come, and I think when it does, it will be far worse than the riots of Britain because: One, we are a much more highly mobile society; two, in Britain they don't have guns where guns are so readily available in this Nation, as we know, but there is such a proliferation of them that it is a very frightening thing to even think of.

It is a very difficult problem and no one seems to want to address it. I suppose it has sort of been swept under the rug because of its difficulty, but I think that in terms of the danger it has to the health and welfare of this Nation that regardless of the fact that it is a difficult problem, it is about time we faced up to it.

Senator HAYAKAWA. Mayor Wilson, I would like to tell you that when I went to the U.S. Senate in 1977 that one of the first items of priority to me was unemployment among black youths.

I don't know the validity to this day of the proposed cure I had for it.

I believed at that time, and I still believe, in a beginner's minimum wage which is somewhat lower than the adult minimum wage.

As a matter of fact, in Britain the adults in the labor movement say you cannot give a lad a man's wages, and the labor movement in Britain certainly approves of a youth minimum wage.

It was certainly opposed by the labor unions here, so ever since 1977, therefore, I have been fighting for this beginner's minimum wage.

At the time I went to the Senate the black unemployment level was something around 30 percent and I thought that was disastrous then and now it is approaching 50 percent, and I think it is even more disastrous.

I pointed out that there is no way of climbing the ladder of success when you can't reach the bottom rung. I just want to throw this into the discussion as one of the possible rules about the enterprise zones.

Can we lift the minimum wage laws or modify them for employment within enterprise zones?

I won't try to answer it now, but I would like to throw that into the kitty.

Well, I have one more question for you.

Mayor WILSON. Yes?

Senator HAYAKAWA. What kind of incentives could the city of Oakland, for example, offer to an enterprise zone in response to the competition for Federal designation as a proper enterprise zone?

Mayor WILSON. Well, one of the ways, I suppose, is we are a city where we have had a very, very strong impact on our finances in recent years; a city that started or began to cut its budget long before anyone had ever thought of proposition 13.

Back in 1974, before I came to this office, the city of Oakland began to cut its budget and has done so every year since, with the exception of 1 year where it was held even.

A little over 1 year ago an assembly research committee studied 20 cities in California to determine the impact, the financial impact of proposition 13. They found it had hit Oakland harder than any of those 20 cities.

So, we will have to find other more creative and inventive ways of participating and contributing to the enterprise zones, and one might be the use of available land.

We have been surveying land owned by the city that is unimproved land. This might be one way in which we could, the city could make a contribution, by attempting to find land that is unimproved land in areas which might be selected for the enterprise zone.

Senator **Hayakawa**. I am very grateful to you, Mayor Wilson, for your very important contribution to our discussion.

Mayor **Wilson**. Thank you, Senator. May I be excused?

Senator **Hayakawa**. Thank you, mayor.

Mr. George Dean, who is president of the California Council of Urban Leagues, is due elsewhere this morning because of a conference which is scheduled. He has asked to be moved forward on the program, so I am glad to welcome George Dean.

STATEMENT OF GEORGE DEAN, PRESIDENT, CALIFORNIA COUNCIL OF URBAN LEAGUES, SACRAMENTO, CALIF.

Mr. **Dean**. Thank you, Senator.

Senator **Hayakawa**. Please proceed.

Mr. **Dean**. Senator Hayakawa——

Senator **Hayakawa**. You represent the California Council of Urban Leagues?

Mr. **Dean**. Yes, I do. My name is George Dean. As you said, I am president of the Sacramento Urban League as well as president of the California Council of Urban Leagues.

The California Council is composed of urban league affiliates in Los Angeles, San Bernardino-Riverside, Orange County, San Diego, San Francisco-Oakland, and the surrounding bay area and, of course, Sacramento.

Since the Urban League began in this country in 1910, and through today, the purpose of the Urban League is to aid in the development of a secure and exemplary American democracy by assisting in ameliorating conditions and solving proglems arising out of inequities with the American system.

For that reason, I am pleased to have been invited to speak on influencing small business investment in enterprise zones.

First of all, let me say that the Urban Leagues' support of the enterprise zone concept is reluctant. Reluctant, first and foremost, because it is the only thing being offered by the administration, that I am aware of, to address the severe problems of our Nation's economically depressed areas.

In addition, my reluctance is based on the following questions as a result of my interpretation of the administration's proposal.

One, will the enterprise zone be the medicine necessary to rejuvenate American cities? Considering the state of the American economy, where interest rates are still exhorbitantly high, where the recession shows no signs of slowing up, where 10—plus million Americans are out of work and the numbers are expected to grow—Sacramento County is presently experiencing an 11.9-percent unemployment rate overall with minority unemployment in the 20- to 25-percent range—where funds for job training programs are being eliminated, where State and local governments are operating on a shoestring and eliminating needed services, I am not convinced that the beginning of the enterprise zones will be the answer the administration says it will be.

In addition, and assuming that enterprise zones do work, since there will be only 25 zones per year for the first 3 years after legislation is enacted, what will happen to all the other depressed areas in the country during those 3 years?

Two, under the administration's proposal, and once legislation is enacted, what will prevent enterprise zones from creating new opportunities for a limited number of depressed areas while lowering standards in other areas; for example, an employer in a locale that is not an enterprise zone moving to a zone area?

This would possibly help the area moved into, but it should surely deprive the area where the company was previously.

And although the administration's proposal is to stimulate new economic activity rather than the relocation of existing business, what are the safeguards to insure this, especially when the free market concept, which is strongly emphasized in the proposal, is taken into consideration?

Three, considering the size of the zone, how many businesses could possibly be located in a designated zone and how many people could be hired?

It could very well be that the number of people from a depressed area that would be hired by a company locating in an enterprise zone would be minimal at best and certainly would have no appreciable effect on the lowering of the unemployment rate.

In addition, what would prevent unemployed workers from moving from a nondesignated area to a zone area thereby exacerbating the problems of residents in the area?

These are just a few of the questions that are raised by the administration's proposal and certainly not all questions that could be asked.

I hasten to point out that these questions and others could also be raised in regard to other proposals concerning enterprise zones.

In keeping with the request to address specific issues before this subcommittee as it relates to influencing small business investment in enterprise zones, I submit the following:

One, tax incentives for small business. It is certainly questionable as to whether or not the tax incentives offered for the enterprise zones will have the effect of stimulating small business.

Small business and new companies often don't make enough profits initially to pay taxes, so tax incentives generally are not what they are seeking.

In addition, the President's Economic Recovery Act of 1981 offered tax breaks for business that are incentives for expansion. I hasten to add that expansion and new business starts have not increased appreciably as a result of the 1981 Recovery Act.

It is generally agreed that small business and new firms are more concerned about seed or startup money, operating costs, labor costs, and how to increase their profit margins before taxes rather than the actual taxes to be paid.

There are many who believe that S. 360 would go much further to help stimulate small business than the zone provisions.

Two, Federal regulatory relief. This would certainly be welcomed by small business and new firms, but once again it would not replace the factors mentioned earlier.

Three, availability of capital and skilled labor. As I mentioned earlier, seed or startup money, or rather the lack of it, is the primary reason that small businesses do not expand or new firms do not start.

The existing proposals are not sufficient to attract capital for small businesses, and especically for minority businesses.

It is felt that incentives for minority business must be immediate and significant. I also believe it is important to keep in mind that although small business accounts for two-thirds of the new jobs, studies also show that at least half and as much as 85 percent of small firms go out of business within 3 years.

These figures cannot be solely contributed to the lack of tax incentives or lack or relief from Federal regulations.

In regards to availability of skilled labor, it is safe to say that there is a large supply of qualifiable persons in just about every depressed area in this country. Since the proposal for enterprise zones is to create jobs, and especially jobs for low-income and hard-to-employ individuals, it would seem to me that provisions would be included in the legislation to provide funds for job training.

To expect small business employers to establish basic job training programs for low-income, hard-to-employ individuals is, in my opinion, asking too much and could very well serve as a deterrent to expanding or starting a new business.

Skilled labor people, in better economic times, can find work. But as I stated earlier, there are many qualifiable people who, with training, would represent available skilled labor.

Four, local infrastucture and crime. Needless to say, the local infrastructure is almost as varied as there are local situations. What will go in Sacramento might not ever be considered in Oakland or vice versa, as an example.

I would say that this holds true not only intrastate, but interstate as well. This would certainly be reason for much politicking and struggles within communities, counties, States, and even nationwide, considering that only a limited number of areas will be designated enterprise zones.

As I mentioned earlier, local and State governments are operating on a shoestring—at least that is true in California and Sacramento—and in spite of the pronouncements of the proponents of enterprise zones, it will surely cost both the local and State governments something to have an enterprise zone program.

Services needed by the businesses in the enterprise zones are going to have to be paid for, and if not by the local government entity, thereby either residents of the area or by the business owners.

To expect the residents to pay for this service is, I believe, a little naive. And if the owners has to pay, this certainly becomes a disincentive to start a business or expand an existing one.

Crime is certainly a problem in most areas of this country and is especially a problem in depressed areas where there are large segments of unemployed persons. Studies reveal that there is a direct correlation between high unemployment and crime.

Needless to say, something would have to be done to curb the crime problem if business is to locate in a high crime area. Once again, there would be a cost involved, and I believe it is extremely naive to expect neighborhood groups or associations to take care of this problem.

This becomes especially true when the neighborhood might very well not be receiving any benefits, other than a very minimal number of jobs as a result of being designated as a zone area.

And if business owners are to pay for the service, it becomes a deterrent for not starting a business, and especially a small business.

In conclusion, the present proposals in regards to enterpise zones are, in my opinion, one, not enough to solve the problems of the Nation's economically depressed areas; two, if enacted, without more stringent regulations than those proposed at this point, leave room for abuse or at best exploitation by some employers; three, will not have a significant impact on lowering the unemployment rate among low-income and hard-to-employ individuals; and four, will not influence small businesses to expand or new businesses to start, and does not address the primary problems of small businesses in order for them to survive.

As I said earlier, the California Council of Urban Leagues' support of the enterprise zone concept is reluctant.

The concept is at least a step in the direction of doing something about the urban problems of our country, but it is only a step, and a small step at that.

I would hope that this committee would impress upon your congressional colleagues, as well as the President and his administration, that more must be done to solve the problems of the Nation's economically depressed areas.

The California Council of Urban Leagues, and I am sure the National Urban League, stands ready to assist the President and the Congress in coming up with meaningful solutions to relieve this country of economically depressed areas.

Thank you.

Senator HAYAKAWA. Mr. Dean, we have been engaged in the war on poverty and the Great Society for nearly 20 years, yet we have not significantly overcome poverty.

So, aside from some of the things that we have tried, what would you recommend, then, to solve this problem? In the case of an experimental program such as the enterprise zones, do you want to try the experiment on the whole country before you try it on 25 zones?

Mr. DEAN. Well, let me say, first of all, Senator, that it is certainly debatable in terms of whether the war on poverty has or has not been won, or has made an impact, I should say. It has not been won, but it is debatable in terms of whether or not it has made an impact on this country.

I think it is safe to say, if you look at statistics, you will find that the war on poverty indeed has made some significant impact. It has certainly reduced the number of people that are considerably below the poverty line.

It has probably done a great deal in terms of increasing the number of children that are able to live that had been dying previously from low weight at birth and so forth.

So, that is debatable in terms of whether or not it has or has not won.

I think the question that you are talking about in terms of its being an experiment, needless to say, regardless of what has happened previously, the country is in trouble.

I don't think that the proposals that we make it an experiment, especially in a limited area, will be enough to solve the problems. People are still going to have problems. It is like reducing people from the welfare roles because you change the rules and regulations.

That does not mean that their needs and demands are not still present.

The same is true with food stamps. People still need food regardless of whether they are eliminated or not.

Senator **Hayakawa**. Well, I am grateful for what you say at the close of your remarks, that the California Council of Urban Leagues and I am sure the Urban League, stands ready to assist the President and the Congress in coming up with meaningful solutions to relieve this country of economically depressed areas.

We shall count on your assistance.

Mr. **Dean**. Thank you, Senator.

Senator **Hayakawa**. Thank you very, very much.

Next we shall have a panel on small business, Mr. Tom Spanier, president of Sullivan Industries of Sonoma, Calif.; Mr. Charles Bridges, president of DYNA-KOR Micrographics, Inc., of Oakland; Mr. Gene Harris, president of EMAC of East Oakland, Calif.

What does EMAC stand for, Mr. Harris?

Mr. **Harris**. Electro-Mechanical Assembly Co., and actually we just eliminated the words and it now is——

Senator **Hayakawa**. Electro-Mechanical——

Mr. **Harris**. Assembly Co.

Senator **Hayakawa**. Mr. Spanier, Mr. Bridges, and Mr. Harris, you are most welcome.

Mr. **Spanier**. Thank you.

Mr. **Bridges**. Thank you, sir.

Senator **Hayakawa**. I invite you to make your presentations. Would you like to head off the panel, Mr. Spanier?

STATEMENT OF THOMAS A. SPANIER, PRESIDENT, SULLIVAN INDUSTRIES, SONOMA, CALIF.

Mr. **Spanier**. Yes, sir. Thank you, Senator. I will reduce my comments on the philosophical end of my testimony.

The subject of influencing small business investment in enterprise zones cannot be adequately addressed in short testimony. I will therefore state the philosophical point of view which I share with many small businessmen, which any legislation must consider, and then I will summarize the business considerations relevant to my specific company.

The objectives of creating jobs and revitalizing economically distressed areas are admirable. The concept of enterprise zones as a free market tool is a contradiction in terms.

The premise that removal of Government burdens and tax relief will expand job opportunities and economic well-being is wholeheartedly accepted. But the placement of limits on who and where the benefits are to flow creates a market distortion.

Such mislabels give the free market system a bad reputation because they don't achieve free market results.

Removal of burdens, from a competitive point of view, are the complement of subsidies—unless evenly distributed, they detract from the natural market equilibrium, benefiting companies not for superior performance, but rather for location, labor composition, et cetera, to the competitive disadvantage of outsiders who may be highly productive.

Distressed areas are components of a larger economy, and shifting the illness by dissipating it through the larger economy does not create a well economy; it just hides the illness better.

Economic growth is achieved through improved productivity, and productivity is improved by competition, not special treatment.

The enterprise zone concept is a plum for recipients, and may well improve the economy within the specified zones. But the benefit will not necessarily come from the miracle of the free market, but rather from a shift of ongoing business into the zone, as is the case in foreign enterprise zones.

Productive small businessmen tend to keep things simple, to concentrate on their business and filling their market need. Government programs such as this one tend to incentivize game players rather than producers.

As an example, Sullivan was a primary victim of the SBA 8-A program, and the primary beneficiary was a large public company. The cost to the Government was substantially higher acquisition cost and deferred R. & D.

The market creates the business opportunities for a small businessman. Special Government subsidy programs provide business opportunity for those who can take the time to figure out how to understand and play the game.

If the market opportunity is there anywhere, then the producer will certainly take advantage of any Government program, but no net gain is necessarily achieved.

I would love to partake of the incentives if I could, but I would feel cheated by the competitive disadvantage of being excluded.

Having established my philosophical overview, I will now address the business development issues, which I would consider if I were to be in a position to participate in an enterprise zone.

The subject is familiar to me, as Sullivan does extensive international business, and coproduction or foreign enterprise zone locations has been seriously considered by us in several places.

The issues to retail versus manufacturing versus distribution enterprise are all different. The relative importance of each issue also varies between urban and rural distressed areas.

The case of Sullivan Industries is typical of a manufacturer in a rural distressed area. We manufacture and export out of our region. We are currently evaluating the development of our real estate to expand our operation and bring in outside manufacturers.

The factors we would consider crucial to small business expansion in an enterprise zone are: One, general market conditions. We have no business without customers who pay for our products.

General economic health in our market area is important, and reduced Government burdens can improve this factor if not specific to defined recipients.

Two, availability of capital.

Three, availability of productive labor. Labor of sufficient capability, having a positive work ethic. Absenteeism, turnover, antibusiness attitudes—which labor-management polarity, strident militancy, prevalence of crime and drug abuse—are costs that economic incentives cannot make up for.

We have had an opportunity to move into numerous foreign free trade zones and we have looked at this factor, and it weighs heavily in our decision.

Four, local support is important. You have to have fire, police, medical and educational services relative to the needs of the specific area, and this is different, of course, if you are in a high-crime area or low-crime area, and so on.

A positive political attitude of local government is necessary to achieve growth, and the enterprise zone concept does demand this, which I think is important.

A big limitation for a rural enterprise is the infrastructure, the physical capacity to support business growth. Utilities, communications, transportation and room for expansion must be available.

We are limited in our location because of sewage disposal. There's nothing we can do about it.

The enterprise zone concept properly demands local support, but I have the feeling that this may put the program out of the reach of many rural areas who are financially unable to support the kind of infrastructure and support services that growth demands.

Sonoma County where we are located is a prime example of this, and I think proposition 13 has accentuated this problem in rural communities throughout California.

In summary, the distressed area development objectives are honorable. The concepts of incentivized economic growth by means of reducing Government regulation and taxation, and improving access to capital, are sound. But limiting the incentives to few recipients distorts competition. The program cannot solve the noneconomic problems of distressed areas which prevent growth, such as work force desirability and so on, and the administration of such a program will likely be very subjective and therefore open to complicated and likely cumbersome rulings, exceptions, conditions, and considerations.

As a first step in an overall program to reduce local, State, and Federal government burdens to spur the economy, the enterprise zone concept is admirable, but why should we limit the relief to specific areas?

We should be improving the overall economic well-being of the country and not just aim at just a few targets to the disadvantage of those who cannot participate.

Senator HAYAKAWA. Thank you, Mr. Spanier. Thank you very much.

Would you like to continue, Mr. Bridges.

STATEMENT OF CHARLES BRIDGES, PRESIDENT, DYNA-KOR MICROGRAPHICS, INC., OAKLAND, CALIF.

Mr. BRIDGES. Thank you very much, Senator Hayakawa.

Senator Hayakawa, members of the committee, good morning. I am Charles P. Bridges, president of DYNA-KOR Micrographics, Inc., a recently developed microfilm service bureau here in the city of Oakland.

I am grateful to have been given the opportunity to address this hearing on influencing small business investment in enterprise zones.

I would like to present my testimony in three parts. First, I will present my background as it relates to the recent development of our small company, illustrating the problems encountered in starting up as well as the problems presently confronting the business.

Second, I will give response to some statements given in the enterprise zone proposal.

Third, I will offer recommendations to the proposal from the vantage point of a small business person.

DYNA-KOR Micrographics, Inc., was established on January 15, 1981, as the only full-line microfilm service bureau in Oakland. It is established as a corporation with seven owners, two of whom are officers.

In the development of the business we experienced the typical startup problems having to do with equipment acquisition, working capital, et cetera.

We had to consistently develop strategies to solve each of those problems and are still struggling with the problem of securing working capital to advance the early growth of the company.

The research division of the Minority Business Development Agency, MBDA, of the U.S. Department of Commerce suggests that new small minority business formation and growth is primarily restricted by the availability of equity and debt capital.

MBDA further indicates that a typical life cycle, a new small enterprise is characterized by six stages: One, feasibility and development; two, startup; three, early growth; four, accelerating growth; five, sustaining growth; and six, maturity.

The capital needs of a business differ, depending on which stage of activity the business is in. The first three stages are periods when the business has no profits and/or cash flows are negative.

During these first three stages, we find most small business failures. DYNA-KOR suggests that a further problem develops in the acquiring of production personnel skilled in the high technology area of micrographics.

Because this category of personnel is usually employed in other firms, the cost of luring those people to a new business is prohibitive.

To solve that problem, DYNA-KOR initiated a training program to develop skilled microfilm technicians. Funding for this program was provided by the Oakland Private Industry Council under title VII, and 5 of the 10 original training participants became the production staff for DYNA-KOR.

The other five participants were placed in other companies.

The training program also enabled DYNA-KOR to stay alive while other startup problems were being dealt with. This kind of effort requires that small business persons be knowledgeable of the resources available to them and pursue like strategies that will keep them afloat.

Small minority businesses engaged in high technology areas also suffer from another startup difficulty. It is the long leadtime for potential clients to determine that the firm is capable of producing a quality product. This results in the delay of contracts which in turn delays the acquisition of accounts receivable.

These are some of the problems and concerns we have found in launching a new small business without the enterprise zone.

Although the underlying concept of the enterprise zone is admirable, there are some crucial questions that need answers for the small business person contemplating the formation of a business within the zone.

The concept states that a purpose is to remove government burdens rather than provide government subsidies. Although there would be no subsidies provided by the Federal Government, most small businesses require startup capital for implementation.

Where will startup and working capital come from? Will financial institutions within the jurisdiction of the zone be given incentives by the Federal, State, or local governments to assist new small businesses with capital requirements?

Tax advantages come specifically after a business has had an opportunity to develop sufficient revenue, and this can occur only after the business has the initial injection of capital needed to proceed.

Also in this regard, how will other services be delivered within the zone? I refer here to services such as marketing consultation, accounting procedures, et cetera. Will firms located within the zone be given Federal incentives to assist new small businesses in the above-type areas?

In the section of the factsheet covering Federal Regulatory Relief, it is indicated that all agencies covered by the Administrative Procedures Act would be given discretionary authority to relax or eliminate their non-statutory requirements within the zone.

In this component, discretion can carry with it a multitude of injustices without checks and balances, which is a major concern of small minority businesses.

Under the area of State and local government role, local community development participation is very vague and needs to be described in more detail.

As an essential component of the enterprise zone concept that will have meaningful impact and stimulate the development of new small businesses, there must be provisions to motivate the financial institutions with adequate financial incentives to make available capital funding.

The lack of capital seed funds has been a well-documented and traditional problem of small business in distressed urban areas. Access to capital continues to be a major barrier to the establishment of new businesses. This is equally important to the survival of already existing businesses within these areas.

There exists at present a formidable array of formal and informal institutional policies that have worked against the cultivation of new business enterprises, particularly those that may be minority and thereby regulated by that fact above to start up in a distressed location.

The zone program must stimulate financial institution incentives to participate in the funding of startup businesses through tax credits, loan guarantees and loan insurances.

Presently, formal institutional financial policies view new startups in distressed areas as ventures, and venture capital by definition is the most difficult to obtain.

Incentives in the form of tax credits should be given to any business that utilizes the products and services of zone businesses.

Burton Milkiel, chairman of the Economics Department at Princeton University, describes the unusual falloff of U.S. productivity as the most basic sickness of the U.S. economy. U.S. productivity measures plummeted from their normal level of annual growth in 1973.

Ever since confusing debates have raged over why this has happened and what we as a Nation should do about it. A consensus is now emerging.

In a developed and complex society like the United States, higher productivity is achieved by a balanced program of, one, creating substantial sources of new financial capital for creating, modernizing, and expanding production facilities; two, supporting programs that create new and more effective products, processes, and production technologies; three, developing more capable human capital in the form of people who are highly motivated to adopt modern workplace technologies and to use them effectively.

Training programs that will be needed for new jobs created in the enterprise zones will demand that detailed attention be paid to the issue of productivity. Training and education in general has been profoundly afflicted by a start-stop kind of approach to the delivery of its services to the public.

We start elementary school and finish elementary school; we start high school and we finish high school; we start college and we finish college and graduate.

Somewhere along the line, most people conclude that they have finished their education and that the subject is closed for life.

This entire stream of commonly accepted ideas is destructive not only to the individuals personal life satisfactions and his or her growth, but also certainly to his or her becoming a more productive member of society.

To this, we must examine training models that consider the whole person and his or her role in the productivity of work. We should also consider the retraining of middle managers whose responsibility it is to motivate and keep productivity as a priority for businesses.

Many middle managers have thought that the way to increased productivity is through negative reinforcement, threats, and bad interpersonal relations. I would recommend that conceptualizers of the enterprise zones examine these issues with regard to training.

It is commendable that the legislature has proposals pending which would address some of these severe economic problems of distressed urban communities

The enterprise zones which would be created by these proposals would be structured to increased the availability of jobs for residents within the zones and to breathe economic life into some of our more depressed areas.

However, the enterprise zone concept fails to address the more fundamental concerns of starting up and maintaining a small business in today's economic climate—whether or not that business falls within the geographic boundaries of a zone.

Workable solutions must be devised to questions regarding the acquisition of seed capital and working capital; something must be done about a financial resource pool that has all but dried up for small business entrepreneurs; thought must be given to shortening long lead times for generating sales in high technology industries; and consideration must be given to the development of skilled employees who would produce products and provide services of a quality that is competitive in the marketplace.

Our recommendations are tied closely to problems we have encountered in starting up and maintaining a minority-owned small business in a topsy-turvy economic environment:

One, provide incentive such as tax credits and loan guarantees to financial institutions to make capital funding available.

Two, provide incentive to other businesses to utilize the products and services of zone businesses.

Three, provide appropriate resources to train zone residents to become qualified employees.

These recommendations are in addition to the already prepared Federal tax incentives and the role State and local governments would play in the program.

Thank you very much, Senator Hayakawa.

Senator **Hayakawa**. Thank you, Mr. Bridges. Thank you for a very, very thoughtful presentation.

May we go on now to Mr. Harris.

STATEMENT OF GENE HARRIS, PRESIDENT, ELECTRO-MECHANICAL ASSEMBLY CO. (EMAC), EAST OAKLAND, CALIF.

Mr. **Harris**. Thank you, Senator Hayakawa. I really appreciate the opportunity to speak here this morning.

I am a small businessman. EMAC is the electronics industry. We provide painting for their hardware that goes on most of the machines, the computers. We are a high density employer.

We are in Oakland. We are located in an area, a problem area, a very high unemployment area, a very high crime area, an area that certainly needs attention.

I am very interested in the enterprise zone concept. I have read some of the documents previously, I don't really have a full understanding yet.

I think there needs to be a lot of other considerations involved here, and I would like to relate some to you today.

Basically, the tax incentive processes, I think, are very important. They have been very important to EMAC in its growth. We have utilized the employee tax credits extensively.

We normally train and employ title VII recipients, which has been beneficial. However, there are certain areas that I think are important that the Federal Government needs to look at.

I think the areas of land, labor, and capital are extremely important. I do not think that these are covered in the enterprise zone concept that I have read. These are very difficult economic times, as you all agree. It is very difficult to obtain capital either to stay in business or to expand.

When you do get capital, it's extremely expensive at a time when you can't afford it.

The land itself is extremely expensive. To expand you are going to have to have room to do so. Small business, in most cases, doesn't have the funds to buy the land. The availability of the capital, I think, it extremely important, especially from the existing financial institutions.

We need financial institutions to help obtain that seed money, that money to expand.

We are a recipient of a UDAG grant which really was experimental in the expansion concept that we have gone through in the last year where we expanded from basically 30 employees to 90, from a 10,000-square-foot building to a 40,000-square-foot building.

Without the UDAG grant, we would not have really been able to expand or I would have given up a lot of control of my company, which I own 100 percent of.

Also, in the electronics industry, I have been able to work with some of the electronic firms in trying to locate into Oakland and we keep running into the same problems.

There are States in the United States that are very attractive to those companies to go to. I think there are a lot of laws that the States have that make this expansion into these States very attractive.

It is very hard to compete against that, so I am hoping that maybe an enterprise zone concept will help compete for those firms to locate in those areas which then gives us the product base to expand onto.

As you know, Oakland has been losing a lot of its industrial base. These companies are moving elsewhere. Why are they moving elsewhere? I hope that the enterprise zone concept taps some of those reasons and maybe would provide an incentive for these firms to locate here.

And since we are in an urban area, we need high density employers. The electronics industry happens to be that type of a business.

We are going to have to improve crime, the crime situation. We are going to have to have education. We are going to have to train our hard core unemployed. We are going to have to have funds to do these things.

If the cities do not have those funds or the States do not have those funds, then what are we going to do? We are going to have a very difficult time in handling these problems.

Maybe the enterprise zone concept can help along these lines.

Senator HAYAKAWA. Thank you very much, Mr. Harris. That was a very thoughtful panel.

Let me ask a question of all three of you. When you started your businesses, what were your principal sources of capital?

Mr. HARRIS. In my case I had a home, so I was able to take a loan, an equity loan, against the home. We started it that way, built up a reputation with the local bank and increased.

But only on a very limited scale. Then the present funding is from the SBA, which is an extremely important source, except it's very, very expensive.

And another thing, I think, is that I don't think they really give us the financial help in terms of guidance that they should. I think this is one area of improvement that the SBA could do a lot better job in.

Senator HAYAKAWA. Mr. Bridges?

Mr. BRIDGES. Yes. For DYNA-KOR Micrographics it was initially capitalized by investment capital of the ownership group. The members of our ownership group put up enough capital which we felt like would give DYNA-KOR an opportunity to get its feet—foundation established with the idea in mind that it certainly was going to demonstrate to the financial institutions that we were going to seek the adequate amount of investment capital that the ownership group was committed to in a capital point of view to the success of DYNA-KOR.

That is where our initial funding came from. That was certainly with the thought in mind to demonstrate that we were all committed to the financial support of DYNA-KOR as we were seeking from the other lending institutions, but it was principally investment capital from the ownership group.

Senator HAYAKAWA. Thank you, Mr. Bridges, Mr. Spanier?

Mr. SPANIER. I had a business idea and our family owns a company and I went to them and I said, "I would like to get this business going. Let's make a deal."

So, we set up the company and for a reduced salary I got some support to get the company going.

Senator HAYAKAWA. So, essentially, capitalization came from one of your family?

Mr. SPANIER. right.

Senator HAYAKAWA. Since this matter of initial capitalization is a matter of great importance and there is no provision for it in the legislation having to do with the enterprise zones, I would like to tell you what is coming up in the program.

The next panel will consist of Mr. Jack Wilson, director of special projects, National Federation of Independent Businesses, and Mr. Oscar Coffey, president of the Black Chamber of Commerce of Northern California.

After that in cleanup position in the batter's order will be Ms. Mable Bell, vice president, Urban Affairs of Northern California, of the Bank of America. Ms. Bell has had a lot of experience in dealing with granting loans and declining to grant loans to small businesses in northern California. She will probably have an awful lot to say from a technical point of view. She will speak last on this morning's program, so I just wanted you to know that this whole problem of capital to start with is going to be dealt with, I hope, in some depth.

But before you break up, gentlemen, are there any Federal Government programs which helped you acquire capital, either to start your business or to help you expand your business?

Mr. HARRIS. UDAG in my case. That was an extremely valuable asset, yes, and the Small Business Administration loan.

Senator HAYAKAWA. Mr. Bridges?

Mr. BRIDGES. Well, one of the most important avenues of financial support that we have gotten is from the Oakland Private Industry Council which has been an organization that has been extremely crucial in not so much the strictest sense of it being start-up capital, but capital that could have been able to allow us to stay alive.

They were an organization under the title VII funds that has been extremely important in providing a source of revenue for DYNA-KOR through its training effort.

Senator **Hayakawa**. So, there is an organization within the city which is over and above that of the Federal Government that could help?

Mr. **Bridges**. that has been one of the organizations that has been instrumental in helping in an extremely important way.

Senator **Hayakawa**. In your case, no help?

Mr. **Spanier**. No help.

Senator **Hayakawa**. What would better assist you in obtaining capital, in your opinion?

Mr. **Bridges**. Senator Hayakawa. one of the things that I feel like I wanted to say in continually thinking about this problem, is that we as small business persons and something that typifies the problem that is experienced by business in general, one of the things that I feel like has been always the foundation or at least the basic premise on which the free enterprise system has been developed is that there has been a profit motive or profit incentive.

One of the things that we have asked the government and other businesses particularly to do is to provide assistance.

And when we are talking about providing assistance to small businesses, that we haven't looked at motivating them on the basic premises for which they have been constructed; to provide financial incentives for them to be involved with, whether it is in an enterprise zone or involved with revitalization of our basic economy, because cur basic economy is built upon small business.

Without that being a part of this free enterprise zone concept, I think that it has very little chance of surviving or succeeding on the level that you want. But if you look at it in terms of providing the adequate motivation, and that motivation being profit or other financial incentives to have the industrial base of this country look at in investing in its depressed areas, then whenever that is successfully accomplished, then we will find the motivation that will bring about the revitalization that you are seeking.

Senator **Hayakawa**. Do you believe that the tax incentives for investors would provide a source of capital?

Mr. **Bridges**. I certainly feel that that would be a step in the right direction, without question.

Mr. **Harris**. For instance, Senator, we have a lot of tax credits from employees that we have had. That is a valuable asset for us, but we can't utilize them unless we have a great deal of bottom line, positive bottom line.

That could be an important asset that we could sell. I think that would be very important.

Senator **Hayakawa**. Sir, Mr. Spanier?

Mr. **Spanier**. I would like to add to that. The tax credits definitely have no use to a startup company or to a marginal company that is involved in the distressed area.

You have to make money to gain by the credit, and generally a small businesses' earnings have a low marginal tax rate, if any at all.

But a good source of capital and one that I am trying to tap for developing facilities is wealthy individuals, for example, who can use tax shelters investments to put into an industrial development project.

Mr. **Harris**. Extremely important.

Senator **Hayakawa**. Very good point.

I have one other question. Would a lower minimum wage for, let's say, people, teenagers—let's say for retired people taking up a new occupation and getting a lower minimum wage while they learn a new job, would that help at all?

Mr. **Bridges**. I would say that it would.

Senator **Hayakawa**. It would?

Mr. **Bridges**. Yes. I would not hesitate in saying that it would certainly provide an opportunity to look closer at the salary structure, which obviously is a cost to small businesses.

Senator **Hayakawa**. Yes. Thank you.

Before you break up, I just want to read you this paragraph from an article in the Public Interest Quarterly.

> Of all net new jobs created in our sample of 5.6 million businesses between 1969 and 1976, two-thirds were created with firms with 20 or fewer employees. Eighty percent was created by firms with 100 or fewer employees.

In other words, small business is a source of new employment far more than is big business and to me that is one of the major reasons for my very, very great interest in small businesses.

Thank you, gentlemen.

Next we will hear from Mr. Jack Wilson, who is director of special projects. Mr. Wilson, please proceed.

STATEMENT OF JACK G. WILSON, DIRECTOR OF SPECIAL PROJECTS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. **Wilson**. Mr. Johnson sends his deep regrets that he is unable to be here. I am here in his place this morning.

Senator **Hayakawa**. The National Federation of Independent Businesses is always welcome in any committee of which I am chairman. They have given me the award at the end of two years since I have been in Congress, so I think they must be great guys.

Mr. **Wilson**. We thank you and look forward to presenting that again.

I am Jack G. Wilson, director of special projects for the National Federation of Independent Business, with an audited membership of 505,207 small business owners across the Nation.[1]

On behalf of NFIB's members, I would like to thank the chairman for this opportunity to express our views on the subject of enterprise zones.

NFIB has monitored closely the development of the enterprise zone concept since it was brought to the United States by Stewart M. Butler shortly after its inception in the United Kingdom.

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[1] Membership total as of Dec. 31, 1981. The audit was conducted by Goss & Marcussen, certified public accountants.

The British devised enterprise zones as an experiment to try and restore the deteriorated portions of that nation's inner cities.

Believing that Britain's inner cities were declining in large part as a result of public policy decisions, such as strict regulation and high taxes, Government officials adopted a utilitarian approach—the enterprise zone—which encompassed minimal Government involvement, significantly reduced regulation and low taxes.

The British experiment, begun in the summer of 1981, has not been in effect long enough to measure its impact. Nevertheless, the enterprise zone concept has already received a great deal of attention and support from Government officials, urban policy experts, and other concerned groups in our country.

Butler refined the enterprise zone idea for application in the United States by incorporating into the concept the work of David Birch at MIT, which empirically demonstrates that small, not large, businesses are the Nation's job creators.[2]

Particularly important to Butler's purpose, Birch produced compelling evidence that the number of jobs lost, as a percentage of the labor force, to layoffs, business failures, et cetera, was virtually identical in any city, be it flourishing or depressed.

The real difference between economically healthy and unhealthy cities was the rate at which new small businesses were created.[3] Based on Birch's work, Butler concluded that the success of an enterprise zone would be dependent upon heavy stimulus to the creation of small businesses rather than incentives for larger entities.

In addition to Birch, Butler has espoused the ideas of sociologist Jane Jacobs[4] regarding the necessity for neighborhood cohesion, cooperation, support, attitudes, et cetera, as being vital to the restoration of inner cities.

To Butler and to many others as well the importance of creating small businesses and the necessity for preserving neighborhoods go hand in hand; hence, his concept that the ideal enterprise zone would be one in which small businesses were owned and operated by residents of the community rather than being imported from elsewhere.

In its original form, Butler's enterprise zone was comprised of three equal parts—experimentation in reduced government, small business, and neighborhood.

What has evolved, however, is a very different equation. The idea is no longer viewed as an experiment, but as the proposed national urban policy.

The proposals which have evolved out of the original concept do not center around the creation of small business, but simply business in gereral.

Finally, the concept of neighborhood preservation and revitalization has been lost in the shuffle. What remains is a package of tax incentives and good intentions.

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[2] David Birch, "The Job Generation Process" (Cambridge, Mass.: M.I.T. Program on Neighborhood and Regional Change, 1979).

[3] David Birch, "The Process Causing Economic Change in Cities" (Cambridge, Mass.: M.I.T. program on Neighborhood and Regional Change, 1979).

[4] Jane Jacobs, "Great American Cities" and "The Economy of Cities" (New York: Random House, 1969).

NFIB polled its membership on two separate occasions on enterprise zones. Both times, September 1980 and June 1981, the response was precisely the same, an overwhelmingly negative 27 percent for, 62 percent against, 11 percent undecided.

If small business, the catalyst for success in Butler's original concept, is so decidedly against the enterprise zone, is it not an indication that something has gone awry between the conceptual and the developmental stages?

Two basic questions need to be asked before any enterprise zone proposal is enacted: Who are the entrepreneurs and what are the most important problems facing urban entrepreneurs in starting up a new business?

NFIB's research provides answers to both questions. Anyone can be an entrepreneur, but certain characteristics seem to be common to the breed in general.

For example, they are better educated than the public as a whole; they are overwhelmingly male and disproportionately Caucasian; they tend to start between the ages of 25 and 40; entrepreneurship tends to run in families—children of an entrepreneur, successful or not, have a much higher propensity to enter their own business; they are moderate risk-takers—neither riverboat gamblers nor stick-in-the-mud personal; independence, the need to build more income, et cetera.

Nevertheless, for what we know of these general characteristics, there is not even a quasi-reliable means of preselecting an individual as a successful entrepreneur.[5]

These entrepreneurs enter their businesses in one of four ways. There is obviously more than one means of entering one's own business.

For present purposes, we are not interested in the inherited, purchased or bought into ownership forms, altough the latter two might be used in a zone.

The focus is on starts. Recently NFIB asked a sample of its urban members to outline the problems they encountered going into their businesses.[6] Aside from the fact that starters reported more problems than did those entering by other means, people entering business in this manner identified four particular problem areas: Learning how to run a business, adequate financing, low initial sales, and finding a good affordable location.

All four were ranked almost identically. Locating qualified employees ranked in the middle.

Taxes, local zoning, regulations, licenses, finding suppliers, and marketing and advertising clustered at the bottom.

Let us examine each of the four most serious in more detail. Outside observers, particularly academics and Dun & Bradstreet, tend to place considerably more emphasis on management than do operating entrepreneurs.

The difference is not surprising, given the fact that many practitioners are neutral managers and were queried on their own expertise in contrast to the more universal view of outside observers.

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[5] "How Small Businesses Begin," unpublished study, NFIB, 1980.

[6] Thomas C. Dandridge and William J. Dennis. Jr., "NFIB Report on Small Business in America's Cities" (San Mateo, Calif., NFIB, 1981).

What is surprising is that successful entrepreneurs identified learning how to run a business with such frequency.

Figures such as 9 of 10 small businesses fail due to management deficiencies abound. While whese figures are open to very serious question on a number of counts,[7] both practitioners and observers agree that management is critical.

It is little wonder that startup and working capital in the first 7 months; that is, low initial sales, plague the aspiring entrepreneur.

Sixty percent have personal resources as their principal source of capitalization;[8] just over one of five have lending institutions as their's, although we have no idea how many unidentified second mortgages are involved; friends and relatives account for another 1 of 10; government and venture capital firms combined constitute a bare 1 percent.

In effect, starters use their own money, their own sweat and their own ingenuity to finance their ventures.

Anyone familiar with small business will not be surprised at the virtually nonexistent role of venture capital and Government programs and the limited role of investors in new business formations.

For the population as a whole, these sources are relatively nonimportant.

But the relatively limited role of lending institutions may raise eyebrows.

It should be noted at the outset that a healthy majority of starts have some money from a lending institution. Curiously, small banks accept about half of their new business loan applications and enjoy a relatively low-loss rate on them.[9]

In contrast, large bank reject three of four and have amuch bigger loss rate on the limited number they accept.

Suggestive data and anecdotes leads us to believe a large share of these loans are personally collateralized.[10] In other words, while debt financing from a lending institution is often available to some extent, it is frequently little more an extension of personal resources.

Finding a good, affordable location was the fourth major problem identified by entrepreneurs as a major startup difficulty. Here we touch the question of location and relocation decisions.

There is a surprising amount of personal relocation occurring among urban entrepreneurs for the purpose of business entry—16 percent.[11] Almost all is short distance. However, virtually none of this personal relocation is for the purpose of a startup.

That means a newly formed business is almost always within commuting distance of the founder's home.

While commuting distance can be substantial, it is more likely than not, given the personal time required in business initiation, that the commute is quite short.

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[7] See, for example, Stahrl Edmunds, W. "Differing Perceptions of Small Business Problems." American Journal of Small Business (Baltimore: University of Baltimore), vol. III, No. 4 (April 1979).

[8] How Small Businesses Begin, unpublished study, NFIB, 1980.

[9] Cynthia A. Glassman and Peter L. Struck, "Survey of Commercial Bank Lending to Small Business," Studies of Small Business Finance (Washington, D.C.: Interagency Task Force on Small Business Finance (1982).

[10] NFIB, "Credit, Banks and Small Business, unpublished survey," 1980.

[11] NFIB, Report on Small Business in America's Cities.

It is important to recognize, however, that small businesses are not static. In fact, 60 percent of urban entrepreneurs have either changed location after business entry or have added a second location.

Almost half have changed their original location.

The reason for relocation or expansion to a different location invariably involves market opportunity.[12] Space and personal reasons are considerably down the line in frequency as a motivating factor.

Government incentives are almost never a major factor. The converse, of course, is that nonmovers remain for the same reason movers move.

It is the market, although in deteriorated neighborhoods the cost of moving is even more important. Relocation is an expensive proposition and not to be taken lightly.

It's no secret there are more favorable and less favorable environments for operation of a small business. In the recent NFIB study on urban small business, those environmental differences were underscored.

The study presented respondents 25 potential problem areas and asked them to rank the severity of each.

Answers were then divided into three classes; those from entrepreneurs located in attractive neighborhoods, average neighborhoods, and rundown neighborhoods.

Comparing answers between those located in average neighborhoods and rundown neighborhoods, it was discovered that 18 of the 25 problems assessed were more severe, statistically significant, in the rundown neighborhoods.

The largest differences were recorded in crime rates, local inspections and inspectors, cost of insurance, unfavorable business location, obtaining needed loans, and locating qualified employees.

Shaping the contrast further, the study examined those seven problem areas where no differences existed: employee turnover, local tax rates, ease in getting licenses of permits, lose skilled employees to larger firms, cost of labor, cost of rent, and low profits.

The impression we are left with is clear, unpleasant, and not surprising.

The disincentives for locating a new business in a depressed area are numerous and large. The labor pool lacks skills, fixed costs such as insurance are high, crime is substantially greater than in other areas, the market has difficulty supporting those firms now established, et cetera.

In short, depressed neighborhoods provide something less than a civil environment for the operation, let alone the institution, of a small business.

If distressed neighborhoods provide less than a civil environment, entrepreneurs should be able to tell us what would produce a more positive climate.

Unfortunately, there is no systematic body of empirically based literature focusing on small business starts.

The NFIB study previously noted and the management literature appear to be all that is available. However, various empirical studies of operating small businesses seem to point to factors other than direct tax incentives as desired and/or motivating factors.

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[12] Ibid.

For example, a study of small businesses in New York showed infrastructure and city services to be the primary concern.

Another study of small businesses relocating from Milwaukee's central city to the suburbs showed the market and transportation to be critical.[13]

Still a third found small businesses following people, and in some cases larger businesses—all of which relate to sales and the market.

Finally, a staff study for the Joint Economic Committee found direct financial incentives of low priority to small entrepreneurs in 10 surveyed cities.[14]

One of the best kept secrets with respect to small business is the population and its distribution. You have probably seen the figure 14 million small businesses. SBA uses it as does practically any small business speaker I have ever heard.

Fourteen million is not an accurate figure if, one, part-time entrepreneurial activity reported to the IRS is included—for example, the Avon lady, the student who takes in typing to put himself through school, the teacher who paints houses during the summer, the factory worker who drives a cab at night, et cetera—two, all farms are counted; and three, all full-time self-employed individuals who do not employ others are incorporated in the total.

That leaves approximately 3.7 to 3.8 million businesses that employ people.

Nearly 70 percent of all small businesses that employ people are to be found in the labor-intensive retail and service sectors; less than 10 percent are located in manufacturing.

No point is more critical to understanding enterprise zones than is the latter.

The ideal types of businesses for location in an enterprise zone would be retail or service firms. They are the most populous.

The cost of startup, particularly for a service firm, is relatively low. They are labor intensive. Employee skills required, particularly for a retail firm, tend to be low.

Minority entrepreneurs have the greatest experience in these sectors. Retail and services firms fit into the neighborhood with minimal disruption.

There is only one problem: no market. Small retail and service businesses are fundamentally dependent on the immediate neighborhood for sales. If an untapped market does exist that could be filled by new businesses, why has it not been filled to date?

Without additional people or income entering the zone, there is no base on which to build a business. No reduction in government can create a market where one doesn't exist.

Essentially, what is required is an export business—a business that sells outside the zone. Income is thereby drawn from other parts of the city, FMFA, et cetera, back to the zone in the form of wages and hopefully profits and local purchases.

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[13] R. A. Erickson, "Environment as 'Push Factor' in the Suburbanization of Business Establishments," Urban Geography 1(2) (1980).

[14] Joint Economic Committee, U.S. Congress, "Central City Businesses—Plans and Problems" (Washington, D.C.: GPO, 1979).

Unfortunately, there is a problem. Unless the zone is to become a warehouse district, which directly violates Butler's idea of neighborhood, one is fundamentally left with manufacturing operations.

But what made retail and service business so attractive in the zone is absent in manufacturing.

There are relatively few of them and their population is declining. Their startup cost is comparatively high. They are capital intensive. Employee skill levels tend to be relatively high.

Minority entrepreneurs have least experience in manufacturing. Manufacturing firms are so attractive that zones will be competing with affluent areas for them. This inherent contradiction is the reason enterprise zones will not work: one segment of small business fits the zone, but the zone doesn't fit it; the other segment of small business doesn't fit the zone, but the zone fits it.

Finally, we would like to point out that as we understand it this is a demonstration program, and since it is a demonstration program, it should be treated in that manner and not eliminate other programs that are presently being used to revitalize small businesses in this country.

Thank you.

Senator HAYAKAWA. Thank you very, very much.

Gentlemen, first I would like to ask a question of Mr. Wilson.

Does your statement preclude the notion that small manufacturing could move into the zone and provide some new jobs with new service sector businesses coming into the zone to serve the manufacturing employees?

Let me be a little more specific about this. As I have contemplated the whole idea of enterprise zones, I have thought about the lobor-intensive kinds of jobs that require no high level of skill, the kind of apparel manufacturing, shoe manufacturing, cheap shoes, support shoes, slippers, things like that, that you find in, for example, Chinatown in San Francisco.

There are corresponding businesses of the kind, not only in Chinatown but in other minority communities.

Wouldn't an enterprise zone be pretty attractive to them and they would be manufacturing and they would have an export marktet, if you desired?

Is there any hope for that kind of low-skill labor-intensive enterprise going into those areas or any other kind that you might think of?

Mr. WILSON. I would think there may be. Our concern was that when polling our members on a broad base and our urban members, we found that the huge percentage of business is in the retail and services areas and that they would be most adaptable to the enterprise zone.

The other export business, which I have described, does have advantage, but there are usually high startup costs involved.

The minority entrepreneur very seldom has experience in that alone. He's very much more able to open a new business in the service or retail field.

Of course, the ideal being here that we want to help the small business and at the same time preserve and restore the enterprise zone, the neighborhood, the local neighborhood.

Yes, I am sure that there is an advantage to the type of business that you have described and I do think that something like that could work, but we want to understand the problems of starting up such a business will be high.

Senator HAYAKAWA. Mr. Wilson, how can the Federal Government help with the problems of crime by insurance and so on, which your members identified as the principal problems of operating a business in an urban area?

That is, law enforcement is very, very much a local function, except for the FBI.

Mr. WILSON. You are asking what Government programs could be instituted to create——

Senator HAYAKAWA. How can the Federal Government help out in the case of local problems of this kind, high insurance, crime, and so on?

Mr. WILSON. Senator, rather than give you an off-the-top-of-the-head answer to that I would like to defer to our Washington staff and ask them to answer directly to your staff.

I am not sure that I am prepared to give that proper consideration.

Senator HAYAKAWA. Mr. Coffey and Mr. Wilson, I would invite both of your comments on this. We do agree, do we not, that the pervasive antipoverty programs have not been successful and have often had an adverse effect of getting people stuck in their poverty?

Is it possible that enterprise zones can shake this up so that people who are now dependent upon Government programs for a livelihood can start working for a living, start getting activated through incentives in the business sector from the point of view of the black chamber of commerce.

You do believe, do you not, that participation in the business process lifts people up, and there are a lot of people needing lifting up, and do you then feel that the enterprise zone will contribute to the lifting up of people from their hopelessness and their poverty to self-respect and economic usefulness?

Mr. WILSON. Yes.

Mr. COFFEY. Yes, I think my opening statement is in support of the mayor's statement with some added suggestions that we support the enterprise zone for a number of reasons, including that lift.

However, I have to point out the fact that many times small businesses, most especially the black businesses and other small minority businesses, they have been faced with the problem of getting adequate funding for all kinds of reasons.

If that is properly addressed, and I think my recommendation of the section 312 loan program is a part of it, yes.

We support it very strongly. I still state, however, that some of the programs that you have addressed in the poverty areas, and obviously in the black business community, we want to see an improvement in business.

But some of the programs perhaps that you have addressed that have not worked perhaps might have been a management problem, not necessarily the program wouldn't have done the effect had it been properly managed.

So, we agree to both, some continuation of those programs that address the needs of people who are—especially senior citizens—there is no real incentive for them to continue work—who are at the sunset of their lifetime.

They would like to relax and take it easy. So, some of the programs that might have been described as poverty programs that had an effect on them should not be abandoned for the sake of enterprise zones, but should both become inclusive.

Mr. WILSON. I think we are saying here, Senator, that everyone in the room is in favor of helping people. We may be following different roadmaps to get to the same goal.

As I mentioned earlier, we like the concept, but we need to review it and look at it again to make sure that we are going to get where we want to go.

One of the things that has been suggested here and in other places is a subminimum wage. Would that sweeten the pot?

We polled our members on that particular issue and 80 percent of our members are definitely in favor of a subminimum wage, but at a national level, not just in one segment or the other.

We are concerned that the subminimum wage will not address the problems that we find from the urban entrepreneurs.

Senator HAYAKAWA. If I introduced the subminimum wage again as a piece of legislation, will NFIB back me up?

In 1977 and 1978 I looked around for allies and I couldn't find any.

Mr. WILSON. Is that to be on a national level?

Senator HAYAKAWA. Yes.

Mr. WILSON. We have an 80 percent mandate of our members that support that position.

Senator HAYAKAWA. Well, I will remind you that I introduced this bill and I have believed in it for so long. I think the juvenile crime, juvenile drugs, juvenile aimlessness, all of these problems we have with juveniles, are so intimately connected with the fact that they don't start working soon enough.

The enormous sense of accomplishment and making your first step toward adulthood as you bring in your first two bucks that you earned yourself, is important. Kids are missing out on this now.

I think it is a shame. It is a terrible thing.

And also it seems to me that television—well, maybe not television, but there are many influences in contemporary life that say that some jobs are beneath one's dignity to perform, like sweeping the store or washing dishes or scrubbing the linoleum, et cetera, et cetera, and you often need these jobs and they say, "Well, I don't do that kind of work," because somehow or other our whole educational system seems to be geared toward making everybody into a white collar worker rather than into a valuable worker.

I find this as I go over the personal biographies of many of my Senate colleagues; a lot of them started out as manual workers, whether to work their way through college or simply to support their families early in life, and they got a college degree ultimately through night school or whatever they did.

But to look down upon manual labor as all too many do now, well, it just hinders the growth of young people. It hinders their maturation.

I'm sure you have all heard this kind of story. You hear a teenager, the first thing you do is come into the room and you say, "Will you sweep the sidewalk in front of the store so that it will be attractive to customers?"

And he says, "I don't do that kind of work." and walks away.

You run into that over and over and over again. It's somehow socially degrading to swing a broom, and we really have some problems. I'm not talking about economic problems now.

How is a young boy going to grow up to be a man if he doesn't go through some of these experiences? The dirty work has to be done to hold civilization together.

Anyway, that's just my opinion.

Mr. **Wilson**. I think that is a good point. We have too many young people who expect something from the system without putting anything in first.

Senator **Hayakawa**. That's right. And lower minimum wage will give young people a chance to make some pocket money. It's not going to hurt them. It will give them some experience and a sense of growing up.

It will be very good for them. I speak now as an educator or maybe a reformed educator rather than a politician.

Thank you gentlemen for your contributions to our discussions.

I would like to call now upon Ms. Mable Bell, vice president of urban affairs in northern California for the Bank of America.

STATEMENT OF MABLE R. BELL, VICE PRESIDENT, URBAN AFFAIRS DEPARTMENT, BANK OF AMERICA, SAN FRANCISCO HEADQUARTERS

Ms. **Bell**. Good morning, Senator.

Senator **Hayakawa**. One of the things I would like you to comment on, curiously, Mr. Wilson of NFIB stated earlier this morning that small banks accept about half their new business loan applications and enjoy a relatively low loss rate on them. In contrast, large banks reject three out of four and have a higher loss rate on the limited number that they accept. Why is that so?

Ms. **Bell**. Well, actually, we as SBA lenders and the largest in the United States can proudly say at Bank of America we have the most minimal and the best loss record in the United States, so I don't know how valid that point might be.

Senator **Hayakawa**. Thank you. Please go ahead with your testimony.

Ms. **Bell**. Mr. Chairman and members of the Senate Small Business Committee, it is my pleasure to be here this morning. My name is Mable Bell, vice president of urban affairs, Bank of America, San Francisco world headquarters.

I have been a member of the banking community for over 32 years and have during these years become well acquainted with small business financing.

Because of this experience I feel qualified to address the subject of today's hearing, the enterprise zones.

In 1968 Bank of America launched and pioneered an affirmative lending program in the urban affairs department of the bank to address the credit needs of small business. We in this department worked closely with the Small Business Administration and other Federal programs to provide credit to small businesses within all of the communities our bank serves in the State of California.

SBA loans constitute only a minute portion of our loans to small business, yet 1 out of every 50 loans made nationwide by the SBA are funded by Bank of America. Since 1968 and through 1981, Bank of America has helped 2,856 businesses with loans totaling $19,463,994, with another 30 loans of $10 million under the new SBA real estate programs.

In 1981, the distressed economic conditions, high interest rates and inflation has limited the debt-servicing capabilities of most small businesses causing our bank and others to make fewer loans in this category.

This adverse trend is continuing on into 1982. Enterprise zones, as proposed, recognize the important role small business plays in our free enterprise system.

According to a 1979 study by David L. Birch of MIT, 60 percent of all new jobs generated in the United States between 1969 and 1976 were created by businesses with 20 or fewer employees.

In addition, 13 million small businesses in the United States constitutes 95 percent of all business and produces almost 45 percent of the gross national product.

Averaging almost 10 employees each, they employ well over 100 million Americans.

The stimulation of economic development in depressed inner cities depends greatly on the ability of small business to gain access to capital markets at affordable rates. The proposal does not address the need of capital for small business.

The use of tax incentives should not be considered as a substitute for capital. The tax incentives suggested would only provide sporadic increases in the cash flow of the small business concern and ignore the capital requirements of new business startups and expansion of small businesses in the enterprise zones.

This would in itself exclude the participation of small business in the zones and deprive the area of an essential economic component for a well-rounded business and residential climate in these depressed urban areas.

The proposal will, on the other hand, attract larger businesses which already have access to capital markets and possess the ability to service the large debt necessary for plant expansion and new construction.

They would fulfill the employment objectives as outlined, and certainly would take full advantage of tax incentives.

The zone in itself also presents a problem. Adequate city improvements and municipal and law enforcement services should be provided. If not provided, all businesses in the zone are placed in a poor environment in areas of high crime, which adds to their cost of doing business through such expenses as higher insurance premiums on coverage for fire, theft, and vandalism.

The outright loss of plant and equipment is also a very real possibility.

The proposal states that the Federal Government will not provide subsidies, but this may be the only way these zones can be fully developed.

The subsidies could be in the form of a two-tier program of assistance to larger and smaller businesses.

By doing this, the Federal Government would then recognize that one solution doesn't fit all sizes or types of business. Under this two-tier program larger businesses would receive the tax subsidies as now in place in the proposal.

Smaller businesses could be helped with low-interest loans for venture capital or special incentives for plant construction and expansion.

The special incentives could be structured similarly to the now revised section 502 Small Business Administration loan program. The program was used in its original form in conjunction with private sector financing.

The blending of the SBA direct funding and the lenders financing resulted in a lower cost long-term commercial real estate loan for the borrowers.

Outright grants could also be made to the small business for each new full-time permanent job created for people living in and around the enterprise zones.

The last area to address might be that of the employment force. Payroll tax reductions may not provide enough incentives. Workers may be attracted if they received other types of benefits.

These could be a job training program, increased rental credits or low-interest Government mortgage loan programs.

The enterprise zone proposed addresses a real need, but it seems to us that you have a way to go before a proposal is formulated that will stimulate all private investment and act as an incentive to entice small business into blighted areas of the United States.

We are pleased the Federal Government is addressing this problem with this program and Bank of America will certainly support the objectives of enterprise zones.

Senator HAYAKAWA. Thank you very much, Ms. Bell.

Ms. Bell, instead of providing direct tax incentives for investors, some argue that the enterprise zone tax benefits to the business would encourage traditional investors to invest in small businesses.

Could you comment on that ploy?

Ms. BELL. You are saying the private sector should take up for venture capital and ongoing loan programs?

Senator HAYAKAWA. That the enterprise zone tax benefits to the businesses would encourage traditional investors to invest in small businesses.

Ms. BELL. I guess there is a possibility it could work through that system, but I don't really believe that a small business person really wants to give up control of their company, and when they go in, they will want to run their own house.

That has been our experience with small businesses. You know, when they go into business, they don't want a lot of interference, and these tax incentives as administered down to smaller businesses might put that into it.

Senator HAYAKAWA. They don't want investors with a large voice running the company?

Ms. **Bell**. I'm sorry?

Senator **Hayakawa**. You say you mean that they don't want investors with large voices running the company?

Ms. **Bell**. No, they don't. Historically they like to be their own man when they fulfill their American dream, which is going into business for themselves.

Senator **Hayakawa**. It reminds me of my father.

Ms. **Bell**. It reminds me of a lot of wonderful success stories I have seen since being in this job for Bank of America in Urban Affairs.

Senator **Hayakawa**. Would the Bank of America, Ms. Bell, be more interested in providing small businesses with seed capital in alternatives to standard debt financing such as if part equity/part debt bonds were available?

Ms. **Bell**. The things that we have used primarily that I can attest to is the guarantee programs and the Government subsidies to small business that have been used.

We participate in many areas of business finance within the State of California on a total broad spectrum, and I wouldn't be qualified to go into the issue of equity bonds.

Senator **Hayakawa**. I understand, of course that Bank of America has huge dealings with huge companies for much of its business.

Dealing with small businesses such as you do is perhaps only a fraction of this business. But as you explained it, the bank itself does take a serious interest in this part of this business.

Ms. **Bell**. Over 95 percent of all the loans that are made in Bank of America are made to small business. The SBA program is a minute part of that program.

The rest is provided through our branch system throughout the State of California, and we address it quite fully because we have always had a commitment to the assistance of small business in our loan programs, long before the SBA came into existence in 1953.

Senator **Hayakawa**. Actually, your founder himself started as a small business.

Ms. **Bell**. That's exactly right. Bank of America at one time was a small business.

Senator **Hayakawa**. Does that sympathy with the beginning business continue as a tradition within that bank?

Ms. **Bell**. Yes, as stated before, we have always had a commitment to small business although it's most difficult at times to address the startup business because when you talk about seed money, you are talking about venture capital.

Senator **Hayakawa**. Yes; of course.

Ms. **Bell**. Venture capital is not historically a part of the banks financial market. We are asset lenders. The venture capital is family, friends, internal investors.

Senator **Hayakawa**. If you were asked by the Small Business Committee to make one najor improvement in the enterprise zone legislation now proposed, what would you suggest?

Ms. **Bell**. I would suggest some sort of cooperation between the Federal, State, and local level to give small business the access to the startup seed money, venture capital market.

Senator HAYAKAWA. Some mechanism by means of which Federal, State, and local——

Ms. BELL. Where they could all share into it. That's the greatest need and the most ignored area for small business at small levels.

There are many, many dollars available for high technology in large amounts, but the lower end is the end that is really ignored.

Senator HAYAKAWA. Well, can State and municipal governments assist the Federal Government in that particular aspect of capitalization?

Ms. BELL. Senator, I wouldn't be able to suggest how that could come about, but I'm sure with ingenuity and good cooperation Government has the resource to formulate something.

Mr. WILSON. You mentioned in your testimony, your written testimony, the SBA 502 program?

Ms. BELL. Yes.

Mr. WILSON. Is that the kind of program that you would encourage which encourages——

Ms. BELL. Yes; during the time that 502 was still in effect, it is still ongoing but not in its original form, the lenders cooperated with the SBA to provide loans to small businesses to acquire real property and equipment. This was through a combination of conventional financing and SBA direct loans. The result of the two rates was a rate at times as low as 12 to 12½ percent.

The 502 program, were it to be reenacted and redirected as a special program, could again provide this type of financing to small business at affordable interest rates as it originally did.

Mr. WILSON. Are you familiar with the SBA 503 program which is a successor to it?

Ms. BELL. Yes; I am. You are talking about a debenture issue. Guaranteed by the SBA which runs more like 15 percent instead of the previous SBA direct rate of 9¾. When you take the blending of the 15 percent with whatever the lenders rate is the result is a much higher cost of servicing debt—503 is a very fine program, but 502, again, addresses the lower end needs.

Senator HAYAKAWA. Well. thank you. Do you have anything further to address, Ms. Bell?

I am grateful to you, Ms. Bell, for your testimony.

In closing, I would like to thank everybody who took part, the business people from businesses large and small. I would like to thank all the people who represented organizations like Urban League, the Black Chambers of Commerce, the National Federation of Independent Business.

I want to thank everybody for their contribution to our enlightenment as a committee today.

I am very, very glad that we managed to get through so much material.

We are going to hold further hearings, of course, and certainly all that you have said here today will go into the record.

We as Senators who are members of the Small Business Committee will be studying all this. So, you can be assured that whatever you have said here in criticism or in support of the whole enterprise zone concept will be taken very seriously into consideration and the ultimate result will be representative at least in part by the contributions made by your experience and your wisdom in these matters.

Again, let me thank all of you for taking part in today's program. The meeting is adjourned.

[Whereupon the hearing was concluded.]

[Additional information follows:]

STATEMENT OF CONGRESSMAN CHARLES PASHAYAN, JR. BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS HEARING CONSIDERING ENTERPRISE ZONE LEGISLATION. April 5, 1982

Thank you for allowing me to speak today in favor of the Enterprise Zone Tax Act of 1982. I am proud to be an original cosponsor of this legislation, and I look forward to its enactment into law. Enterprise zones promise to provide aid to economically depressed communities by freeing those in the communities from burdensome taxes and regulation.

Many recent Federal programs have been directed at providing relief to poor communities. For the most part, these programs have comprised some type of Federal grant combined with regulations governing the expenditure of these grant funds. While much good has been accomplished by many of these programs, they have not eliminated or substantially reduced the problems associated with economically weak cities and rural communities.

The Enterprise Zone Tax Act promises to provide aid to these communities by taking a different approach. Enterprise zones do not rely on Federal grants and their associated regulatory framework to provide economic relief. Rather, they will remove much of the tax and regulatory burden which hinders the economic development of poor communities. The removal of tax and regulatory burdens from these communities will both induce new business interests to locate in enterprise zones and provide new economic incentives to those already located in the zones.

The residents of economically depressed communities have a far greater incentive to see their neighborhoods revitalized than does anybody else. The enterprise zone concept recognizes this fact and is based upon the need to unlock the latent economic drive of these residents. Federal taxation and regulation place constraints on all businesses. These constraints have the greatest impact on the poorest communities. The removal of such contraints will allow businesses in the zones to realize a greater economic return on their efforts. This, in turn, will help to unlock the latent economic potential of these areas.

I do have concerns about the relative absence in the Enterprise Zone Tax Act of provisions specifically designed to promote small businesses. While many of the provisions of the bill will provide benefits to small businesses, these benefits are marginal at best. The bill's reliance upon non-refundable tax credits will provide the greatest benefit to those businesses already earning profits and will do very little to encourage the formation of new small businesses in economically depressed communities.

I am also concerned that the interests of small communities may be overlooked as the focus of Federal aid to communities shifts to the Enterprise Zone concept. The bill calls for the establishment of 75 zones within the first three years after the enactment of the Act. While I am aware that any change in Federal aid programs of this magnitude must be conducted carefully and methodically so that the results of the new program can be adequately monitored and evaluated, I feel that the interests of our smaller communities must be protected. I can easily foresee the success of 75 enterprise zones in larger cities--and I do think that they will be successful--causing us to forget the needs of smaller but no less needy communities. We must remember the needs not only of depressed communities in large cities but also of the needs of our mamy hundreds of smaller towns.

Again, thank you for giving me the opportunity to speak on this issue. I see these hearings as one of the first steps in the enactment of this important legislation.

TESTIMONY OF
A. RON RHONE
BEFORE
THE SELECT COMMITTEE ON SMALL BUSINESS
OF THE
UNITED STATES SENATE

April 5, 1982
Oakland, California

My name is A. Ron Rhone. I am a Small Businessman from Richmond, California.

I would like to thank you Senator, for the opportunity to share with the Committee, some of the concerns of small businessmen who are at present operating in areas that would be affected by Enterprise Zone legislation. Before listing any specific concerns, I would like to state that, in general, businessmen like myself in these areas are not only willing, but eager, to cooperate in developing and applying the concept of Enterprise Zones.

All of us are intimately familiar with how the problems of urban decay and unemployment came about. Many of us are also familiar with the different programs and policies that the Federal, State and local governments have undertaken over the past 10 years to alleviate these problems. We have seen first hand what these programs tried to do and how they failed. I myself, as Manpower Director for 5 years in the city of Richmond, have had an opportunity to closely watch and evaluate these programs. Any concerns or criticisms that I or others like me may voice do not come from a reluctance to participate in an Enterprise Zone program. Rather, they come from a concern that any Enterprise Zone program avoid the problems that crippled the effectiveness of other urban programs.

We are willing Senator, to give Enterprise Zones a try. We are committed to the revitalization of our urban areas. We are simply concerned that any Enterprise Zone legislation be an effective solution where other programs have failed.

One of the primary goals of Enterprise Zones is to provide a solution to the chronic unemployment problems faced by citizens in the affected areas. The biggest failure of the CETA jobs program was that while it provided funds for training, it did not insure any long term employment following the training period. Unemployment in these areas will only be alleviated with the creation of a permanent job structure. People who are hired and trained at a low wage and then dismissed once their job training is over, are not substantially better off than when they were before. Once the unemployed are put to work there must be incentives for their employers to keep them working.

I believe that two of the policies under consideration with this legislation could help to remedy this problem. The policies are; the requirement that businesses operating within the Enterprise Zone hire a fixed percentage of their employees from the population within that Zone, and that businesses receive a tax credit for their continuing employment of each of these individuals. I believe this will substantially eliminate the problems that occured in the CETA prgram and avoid the problem of a large company moving into the Zone and bringing other employees with it from outside the area. I would further suggest that it be the specific responsibility of the Federal government to insure compliance with this part of the program.

In the last several years, a new type of unemployment has arisen in our cities that could be addressed by Enterprise Zone legislation. That is the problem of increasing unemployment among the skilled work force due to lay-offs from major corporations caused by our declining national economy.

Various supporters of Enterprise Zone legislation have shown that it can be an effective tool for solving the problems of the chronically unemployed. A great deal of emphasis has been placed on the ability of this program to generate jobs for the unskilled worker. But, as the jobless rate increases among skilled workers, it is becoming increasingly clear that if this legislation is to be fully effective, it needs to address the problems of unemployed skilled workers as well. I would suggest that in drafting this legislation, you consider as part of it, specific incentives for the creation in Enterprise Zones, of businesses hiring skilled workers and specific incentives for businesses to retrain skilled workers who have been layed off.

Having addressed my comments so far to the needs of the unemployed of the community, I would now like to comment on what businessmen will need, in order to do their part in making this program a success.

First, there is a continuing need among small businessmen in these urban areas for low cost capital for investment and expansion. I would encourage that this legislation take into account the need for small business loans. I believe the incentives proposed in the Enterprise Zone legislation will substantially alleviate past problems of loan defaults among businesses in these areas. The tax incentives proposed in this legislstion are designed to reduce the risks involved in setting up or expanding businesses in these areas. I believe that these incentives will be equally effective in reducing the loan risks for these businesses as well.

Another continuing concern of all businessmen is the amount of paper work, regulation and bureaucracy involved in any government program.

As I stated earlier, I believe that it will be necessary to have strong Federal Government oversight to insure that there is proper compliance with the basic requirements of this program. However, it must be clear from the beginning that the planning and development of each Zone, within the guidelines of the Federal legislation, is the responsibility of the local government. Only in this way can it be insured that each Enterprise Zone will receive broad citizen input and support in each stage of its development. If this legislation is passed, we cannot afford to have it crippled by layer upon layer of Federal, State and local bureaucracy.

In closing, I would again like to state that is properly constructed, this legislation can go a long way to solving the problems of all our urban areas, both large and small. I would like to remind the Committee that for every major urban area such as Oakland that this legislation could help, there are at least a dozen others like Richmond with the same problems and needs on a small scale that could benefit from it as well. If the program is flexible and responsive enough, all of us, in large and small cities will benefit equally from it.

The one statement more than any other that I would like to leave with this Committee is; that there are many smallercities that need this legislation just as much as the larger cities do. Those of us who live and work in these smaller cities are waiting and watching for your actions. We are willing to work and help. We only ask that our needs be considered too. Once again, thank you for this opportunity and I will be happy to answer any of your questions.

INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

WEDNESDAY, APRIL 7, 1982

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Chicago, Ill.

The committee met, pursuant to notice, at 10:30 a.m., at 2525 Dirksen Federal Building, Chicago, Ill., Hon. Alan J. Dixon, acting chairman, presiding.

Present: Senator Dixon.

Also present: Robert J. Dotchin, staff director; Robert M. Wilson, counsel; and Alan L. Chvotkin, minority chief counsel.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIXON. Ladies and gentlemen, on behalf of Senator Lowell Weicker of the Senate Small Business Committee of the United States and Senator Sam Nunn, our ranking members of the committee, I am pleased to be here in the city of Chicago on behalf of the Small Business Committee to hold a hearing on the enterprise zone concept. I would like to announce to all of you that we have a schedule here in connection with the hearing, and that schedule will be religiously adhered to.

Governor Thompson will be the first witness. A representative of Mayor Byrne will be the second witness. And then there will be several panels.

The first panel will consist of Maynard Wishner, president of Walter E. Heller; David Leavitt, president of UNR-Leavitt Industries of Chicago; Mr. Edwin Crego of Consult, Ltd., of Chicago.

The second panel will consist of Mr. Mel Boldt, president of the Independent Business Association of Illinois; Mr. Joseph Williams, Minority Purchasing Council of Chicago; a representative of the Illinois treasurer's office, Mr. Charles Weber.

And the third panel will consist of Mr. James Fitch, president of the South Chicago Savings Bank; the executive director of CANDO, Mr. James Patterson; and Mr. John Mullins of the DeKalb Economic Development Council of Illinois.

On behalf of the Senate Small Business Committee, I welcome this opportunity to explore the enterprise zone concept from an Illinois perspective. Because it is the neighborhoods in our cities which are the focus of the enterprise zone program, it is particularly appropriate to hold hearings outside of Washington in the areas which may be affected, and to hear from the local government officials, lenders, and entrepreneurs who are such an integral part of the enterprise zone concept.

The enterprise zone program is designed to revitalize depressed urban areas by removing unnecessary regulatory and tax barriers in these areas. Unlike past urban programs, enterprise zones do not involve any direct government intervention. Instead, the Federal Government's role should be to provide certain incentives, and allow the private sector to take advantage of these incentives. The theory is logical, but many questions of implementation remain unanswered.

In February, the Senate Small Business Committee held its initial bearings in Washington to review the potential role of small business in an enterprise zone program. Among the major criticism the committee heard at that hearing regarding the pending enterprise zone bills was their failure to insure the availability of, and access to, startup capital to new businesses which might open in enterprise zones. The President's own enterprise zone proposal released 2 weeks ago also fails to address this need. Without insuring the availability of that crucial seed capital, the witnesses told the committee, the tax and regulatory incentives—which under every proposal would be available to a business only after it is operating—would mean little if anything, and have no impact on a business decision on where to locate. New businesses would never get off the ground in the first place.

Several suggestions on how to increase the availability of startup capital have been made. These include increasing the tax-free interest on loans made to enterprise zone businesses beyond the levels already proposed; making investments in enterprise zone businesses 100 percent tax deductible; and incorporating the small business investment company and minority enterprise Small Business Investment Company programs into enterprise zone legislation. Each of these suggestions has merit, and should be carefully taken into consideration during our committee's, and congressional debate.

I am confident that the crucial problem of startup capital will be addressed by some of the witnesses today. Small businesses create 65 percent of all new jobs. If an enterprise zone system is to work, it must be targeted to that sector of the business community that is most likely to provide the solutions. Therefore, the interests and needs of small business in any enterprise zone must be protected, including the availability of startup capital.

I am also sure that the concerns local government officials, businessmen and lenders have with the enterprise zone program will be aired today. In order to insure the success of an enterprise zone proposal, we must hear from those directly affected; we need to know exactly which regulations create the greatest barriers to entrepreneurial activity; we want to know how local governments would create an entrepreneurial climate; we want to know what needs to be done to encourage lenders to invest in enterprise zone companies.

The Federal and local governments, and the private sector, must work together in order for the program's goal of urban revitalization to be realized. The Federal Government alone can't make the enterprise zone program work. Nor should the Federal Government seek to develop the rules of the game alone. But by considering the problems of intergovernmental and private sector cooperation today in Chicago, and elsewhere around the country, Congress will be in a better position to tailor Federal enterprise zone legislation to meet the needs of our communities.

As we discuss these problems, let us remember that it is the fundamental needs of our people that are at stake. The enterprise zone theory foresees increased employment, revitalized neighborhoods and a greater level of commerical activity in our depressed areas. All are worthy goals. With your help, we can accomplish them.

I thank you very much for attending this hearing today. I am told that Governor Thompson is here and we welcome the chief executive of our great State to this hearing in Chicago. We are delighted to have him come in.

Governor Thompson, we are delighted to have you here. I have made an opening statement prior to your appearance. And on behalf of Senator Weicker, chairman of the Small Business Committee, Senator Nunn, and all the members of the committee, I thank you for taking time out to come to the city of Chicago and giving us your views on the entire question of the enterprise zone concept not just the administration's proposal or any specific proposal pending in Congress.

STATEMENT OF HON. JAMES R. THOMPSON, GOVERNOR, STATE OF ILLINOIS

Governor THOMPSON. Thank you. I brought with me, and I apologize for not getting it to the committee earlier under the provisions of your rules, but we have been scrambling to respond to the administration's proposal for which we have been waiting. So, I would like to take this opportunity this morning to summarize it because I know your schedule is a full one and the statement is somewhat more in length than you ordinarily take before subcommittees of this of nature. And I would like to speak a little bit about the State's responsibility in the enterprise zone concept.

From your schedule, I see you will have representatives of local government and representatives of the business and labor communities concerning the nature of their participation in the enterprise zone concept. You will undoubtedly be examining the President's bill and proposals. And I think it would be most appropriate in terms of my appearance before this committee to tell you what we are doing in Illinois at a State level, what we have done to clear up any misconceptions or confusion that may exist there.

First of all, I would like to thank the committee for coming to Chicago. As I said to your colleague, Senator Percy, when he conducted a similar hearing at Argonne National Laboratories on the question of funding for our regional laboratories in the proposed budget for the fiscal year 1983, my view, and this may have a ring of the New Federalism in it, my view is more often that those who make the ultimate decisions should come back home and hear in the field the impact that proposals will ultimately have. You can hear more of our people.

And I know that you have been a leader in promulgating that concept, not only with an Illinois delegation, but with the Congress since your taking of the Senate seat a little over a year ago. I think your willingness to take your time from Washington, where I know you are grappling with the budget in the Senate and grappling with recession, to come to Chicago to encourage the people of Illinois to comment on proposals that may prove to be part of or a piece of the economic salvation of this State is most encouraging to me as the Governor, and most encouraging to fellow citizens who sent you there. So, I thank you for coming and listening to us today.

We have learned the lesson in Illinois that the vitality of small- and medium-size businesses will forecast the economic outcome for a State, even a State as large as Illinois. We are proud that Illinois is the host, the corporate headquarters of the most Fortune 500 companies, second only in the Nation. That is important to our economy and to our business and our civic life.

But for the people of our State, their economic opportunity depends upon their ability to get and hold jobs. And we have finally learned the lesson and the Nation is learning the lesson and legislatures are learning the lesson and Congress is learning the lesson that by whatever yardstick you measure, 70 to 90 percent of all the new jobs in this Nation are crearted by small- and medium-size businesses.

And it is to them that we must direct more and more of our attention, how regulations affect them, how the tax structure affects them, how access to capital affects them, how community services affect them. And for that reason, I think the enterprise zone concept, however it finally comes out, it is critically important as just one piece of the partnership between private enterprise, government, and labor and the university community that must be put in if we are to keep small- and medium-sized businesses economically strong.

That is why we in Illinois have been willing to invest our time and our resources in furthering the enterprise zone concept. That is why we in Illinois, for example, have not written off cities like Chicago or Detroit or New York or Newark. But instead, we have looked for ways to restore them, to repair infrastructures rather than creating new ones.

Let me tell you, Senator, what we have done in Illinois because there is sometimes confusion over our attitude in the State administration toward the enterprise zone concept. Last year, the Illinois General Assembly passed an enterprise zone bill. I vetoed it. In my veto message, I stated explicitly that I favored it and favored it stoutly. I vetoed that bill known as the Enterprise Zone Act because it didn't accomplish what was sought to be accomplished by the enterprise zone concept. It was at odds with the Kemp-Garcia bill. It was at odds with what we anticipated the bill promulgated by the Reagan administration.

It did not define an enterprise zone. It forbade rather than encouraged incentives from government to help businesses moving into the zone during the early critical risk years.

And it was our notion that if you are going to the trouble and the expense of creating enterprise zones, you have got to give all the possible help you can get within the enterprise zones in order to make them succeed. And yet, this bill specifically forbade in a number of instances government incentives to make the enterprise zones work.

But I didn't stop in the veto of that bill because I knew the administration would be coming forth with one. I knew that Congress would be coming forth with their own ideas. And I wanted Illinois to be on board.

Under the chairmanship of Allison Davis, an attorney in Chicago who works with nonprofit financing projects for inner-city ventures and has some experience in this area, we created a task force to draft a new bill for consideration by this session of the Illinois General Assembly. That task force has been meeting weekly since February. That task force includes all of the experts in Illinois that we can find from the business, labor and university and philanthropic organizations who know everything there is to know about the concept of enterprise zones, even if they all don't agree.

They are in the process of drafting a report which will come to me at the end of the week and which I will forward immediately to the subcommittee and a bill is being readied for introduction into the Illinois General Assembly. We want to be ready when the Congress and the administration are ready.

Let me also just point out that what we have done last year in an effort to prepare ourselves for the enterprise zone concept on a broader base across the State, trying every way we can to improve and stabilize economic opportunities for small business.

Last year, the legislature passed and I signed the Illinois regulatory flexibility bill sponsored by Senator Bloom. It compels State agencies of government to assess the effect of regulation on small business and to alter rules accordingly, striving for balance between the needs of government to regulate and protect people. But it is also to make sure that regulations are not so burdensome that they cripple the efforts of small- and medium-size businesses to begin and prosper.

Our Department of Commerce and Community Affairs, which was totally reorganized several years ago and now is a most aggressive department, acts as an ombudsman for business in regulatory relief.

This approach is part of a larger program which seeks to create the specific conditions necessary for adding or creating jobs. We believe that our goal should be to test the notion of enterprise zones as part of a larger responsive approach to small- and medium-size businesses, treating enterprise zones as just one piece of an entire mosaic of government's relationship to small business and medium-sized businesses as I have outlined.

Let me describe some of the approaches that I believe ought to be incorporated in a bill. The entire program should be treated as an experiment. I concur with the Reagan administration's approach to test the concept and would expect the State of Illinois to take the same posture. This means limiting the program and assessing its results, expecting that in some instances it will fail, expecting that in some instances government will make mistakes, but knowing in advance that that will happen and being ready to profit by those mistakes and to correct the failures.

No. 2 is the State must work closely and carefully with local government in an establishment of such zones. Zone operation should reflect a partnership as well. The State should encourage experimentation as local effort is critical to success of zones.

Local and State partnership should also include efforts to benefit residents and businesses in the zone communities.

No. 3—we should design initiatives involving regulatory relief in existing programs and tax incentives. Any incentives should encourage new investment and jobs, but regulatory relief should not undercut health, safety, or civil rights. A balance must be struck.

We also believe that incentives alone cannot turn the tide. They will not magically transform neighborhoods on the near south side or near west side of the city of Chicago which consist now of empty lots or empty factories or decayed housing stock. Services must be improved. Neighborhood organizations must be involved and clear objectives must be set.

It must be safe for people to live there. It must be safe for people to work there. It must be safe for people to educate their children there. And the education must be quality education if the enterprise zone concept is to work.

To me, the enterprise zone is far more than tax incentives or regulatory relief which brings in five or six businesses within a defined geographical area. It is a re-creation of a community which once existed and for which the passage of time has witnessed a marked deterioration.

Residents must feel safe living there. They must feel safe working there. It will not work if the schools are not of quality and operate separately from the total community.

And government alone cannot assure that. Only a Federal-State-local community organization partnership can make such assurances. And we must not be afraid to experiment from zone to zone because the requirements of the west side of the city of Chicago may be different from the requirements of a rural area in downstate Illinois, or the requirements of a medium-sized community in downstate Illinois.

The State should attempt to assist with the formidable problem of capital formation through stimulating greater private investment, or encouraging zones based on private proposals for appropriate use of capital instruments, such as bonds.

Capital has been proven time after time to be the critical need for small businesses. And the State could be a partner in leveraging such resources. We here in Illinois have attempted to respond to that need in a joint program that I have undertaken with the treasurer of the State of Illinois. We have targeted the investment of State funds in housing and in agriculture. We are about to begin a program in targeting the investment of State funds in wider areas as well.

But even beyond the investment of State resources as an investment of the treasurer's office with which you are intimately familiar, the State must aid in the process of doing more to assure the formation of capital pools for entrepreneurial or high-risk businesses outside the normal channels of banking commerce.

We are about to announce a program in Illinois in which banks have agreed to pool assets in a corporation to give special consideration to small- and medium-sized business loans which cannot be obtained through ordinary mechanisms in return for a share of the equity, but not a share of control of the entrepreneurial venture.

Special consideration should be given for zone proposals in areas related to business assistance and development, such as management assistance and job training. Again, if we wish the zones to serve as innovators of new ventures, these efforts are necessary.

Businesses and communities should expect responsiveness from all levels of government in these areas. I think the goals should be to increase the likelihood of success without undercutting the market through direct subsidy. These points reflect the State's overall posture of working creatively with both Federal and local government in depressed areas. And it clearly is desirable to encourage community and business involvement in job and ownership opportunities.

Also, I think we have to under stand that the goal of economic revitalization cannot be attained by any one program as exciting as the enterprise zone concept is. We must understand that even if successful, it is only a piece of the government, business, labor, and university community.

A recent publication of Continental Bank's area development division lists 49 things to check before you locate and build your ment; included are community attitudes, education, labor force, fire and police protection, medical services, and transportation.

A recent publication of Continental Bank's Area Development Division lists 49 things to check before you locate and build your plant. Clearly, corporate location or startup decisions involve a complex assessment of a variety of community indicators in addition to the legendary hard work required for new businesses.

This program or any one level of government cannot fill this individually in and of itself.

Finally, we as public officials, I think, have a difficult problem in designing this program which is why this hearing is clearly necessary and important, and why I assume it will be replicated throughout the United States before the Congress reaches a concrete set of proposals. The task of creating a set of incentives which will attract businesses and jobs is only one dimension of the problem.

The other dimension is to do so in such a manner that people who live outside enterprise zones do not see precious resources drained away, and that businesses outside enterprise zones are not placed in a substandard competitive position.

The effort to create incentives for a new set of urban pioneers such as we did with our land in the West more than 100 years ago is lauded. The race to do this cannot discourage any other participation in markets which should ideally continue to prosper. Applying this to enterprise zones, we recognize that a flexible partnership involving government, business, labor, and communities needs to be the larger agenda for depressed areas. For only then can we hope to restore our inner cities. And providing business and job opportunities is an excellent initiative. And that is the kind of enterprise that we have in Illinois and that I will pledge the State government to.

[The prepared statement of Governor Thompson follows:]

TESTIMONY
OF THE
HONORABLE JAMES R. THOMPSON
GOVERNOR, STATE OF ILLINOIS

Thank you Senator Dixon for this opportunity to discuss Enterprise Zones and the encouragement of small business. I appreciate the local scheduling of this hearing on this vital issue. The interest and support of you, Senator Percy, and the members of the Illinois Congressional delegation is thoughtful and informative as usual. I take note of your interest in small business and enterprise zones and also the fact that Senator Percy is a co-sponsor of the administration's bill on this matter. Your continued work is both noted and recognized.

Small business remains a major economic force in Illinois. National surveys continually show that most jobs, innovations and creative efforts come from the backbone of our economy, the small businessman or woman. In Illinois, this is the corner store, the loft manufacturer, the small laboratory. While I may stop just short of saying "small is beautiful", I can say small is creative, small is accessible and small is the future!

We see definite possibilities for small businesses in enterprise zones. Enterprise zones are conceived of as geographic areas where the climate for investment can be improved by a series of incentives and relaxed restrictions. This approach is designed to restore the commercial vitality of depressed areas in the State using the private sector as the chief resource. Properly nurtured through creative public-private partnerships, we think it can work. In Illinois, we intend to go one step further - to use this concept as another tool to revitalize urban and smaller city areas ravaged by economic decay.

This attractive idea of enterprise zones - to remove the burden of government from depressed urban areas - is compelling in its simplicity. In order to design the proper mix of incentives and partnerships, I appointed a task force to review the possibilities and design a State-level approach. Under the chairmanship of Allison Davis, a local attorney who works with a non-profit capital financing project for inner city ventures, this task force has met weekly since February to design a program. As I will not receive their report for several more days, my remarks will reflect our general thinking on the matter. I would be happy to advise the committee further at a later date ~~if~~ desirable.

In Illinois we have learned that paying attention to existing business, particularly small and medium-sized firms, also yields a handsome reward through retention and expansion. We have often been successful because of the partnership between labor, business and government that we have worked carefully to establish. This partnership should be reflected through responsive and flexible government. With respect to small business, an example of this is the Illinois Regulatory Flexibility Act which compels state agencies to assess the effect of regulation upon small business and alter rules accordingly. Our Commerce Department also acts as a ombudsman for business in regulatory relief. This approach is part of a larger program which seeks to create the specific conditions necessary for adding or creating jobs. Our goal should be to test the notion of enterprise zones as part of a larger, responsive approach to small business.

Having briefly outlined the Enterprise Zone concept, the context in which it should be placed, and its Illinois history, let me describe some of the approaches I believe we must incorporate:

(1) the entire program should be treated as an experiment - I concur with the Reagan Adminisration's plan to test the concept and would expect the State to take the same posture - this means limiting the program and assessing its results,

(2) the state must work closely and carefully with local government in establishment of such zones; zone operations should reflect a programmatic partnership as well - the State should encourage experimentation as local effort is critical to success of zones; this local-State partnership should also include efforts to benefit residents and businesses in zone communities,

(3) we should design initiatives involving regulatory relief, existing programs and tax incentives; however, any incentives should encourage new investment and jobs while regulatory relief should not undercut health, safety or civil rights. However, I would point out that incentives alone cannot turn the tide. Services must be improved, neighborhood organizations involved

and clear objectives set. This is also reflected in the Administration's bill.

(4) the State should attempt to assist with the formidable problem of capital formation through stimulating greater private investment and encouraging zone based proposals for the appropriate use of capital instruments such as bonds. Capital has been proven time after time to be the critical need for small business. The State could be a partner in leveraging such resources,

(5) special consideration should be given for zone proposals in areas related to business assistance and development such as management assistance and job training; again, if we wish these zones to serve as incubators of new ventures, these efforts are necessary. Business and communities should expect responsiveness from all levels of government in these areas. I think the goal should be to increase the likelihood of success for small businesses without undercutting the market through direct subsidy,

These points reflect the State's overall posture of working creatively with both Federal and local government to encourage business vitality in depressed areas. Further, it is clearly desirable to encourage community and business involvement in job and ownership opportunities.

We as public officials have a difficult problem in designing this program. The task of creating a set of incentives which will attract business and jobs is only one dimension of the problem. The other dimension is to do so in such a manner that people who live outside enterprise zones do not see precious resources drained away and that businesses outside enterprise zones are not placed in a substandard position in market competition. The effort to create incentives for a new set of urban pioneers is laudable - the race to do this cannot deny other participation in programs for which they are eligible or markets which should ideally contain un-subsidized competitors. This problem is to be faced in the context that we are to compete with other localities in order to receive Federal zone designation.

The goal of economic revitalization cannot be attained by any one program. A recent paper on Industrial Development by the Illinois State Chamber of Commerce lists 12 sets of questions to be asked when assessing an area's potential for investment. Included are community attitudes, education, labor force, fire and police protection, medical servies and transportation. The title of a recent publication of Continental Bank's Area Development Division, "49 Things To Check Before You Locate and Build Your Plant," echoes this point. Clearly, corporate location or start-up decisions involve complex assessment of a variety of community indicators in addition to the legendary hard work required for new ventures. I cannot see this program or any one level of government filling the void in and of itself.

Applying this to Enterprise Zones, we recognize that a flexible partnership involving government, business, labor and communities needs to be the larger agenda for depressed areas. Only then can we hope to restore our inner cities and replace distress with success. Encouraging the independent, aggressive spirit of small business in the context of redeveloping these communities and providing busines and job opportunities is an excellent initiative. And that's the kind of enterprise I pledge our energies to!

Senator DIXON. I want to thank you for a very fine presentation. It is clear that you and your administration have given attention to the enterprise zone concept. I thought I might point out to you, in connection with the five points you made which are all laudible ones, that there are four elements to the enterprise zone bill proposed by the administration. It might be interesting to note that they essentially parallel, to a large extent, the ones you have suggested. These are tax reduction at the Federal, State, and local levels to lessen the obvious burden on economic activities; regulatory relief at the Federal, State, and local levels to reduce burdens which can be equally costly; new efforts to improve local services, and it is interesting that you include private alternatives to provide the services; and involvement in the program by neighborhood organizations, a point which you have made and which I think is perfectly pertinent to our discussion here today.

And I take it from your testimony, Governor, that your administration has taken these steps to be on line when this legislation—when and if this legislation is passed by the Congress.

Governor THOMPSON. Yes, sir.

Senator DIXON. I would call your attention to the fact that I said in my discussion with the press earlier, and as you pointed out, that enterprise zones should first be a pilot project. And that is the concept of this bill. It calls for 25 zones a year for 3 years.

And I would point out that in view of this, there will be considerable competition throughout the country. And it is clear here that you are indicating your support. Mayor Byrne is sending someone here. The State treasurer who has done some fine work in this field, has a representative here.

I get the impression that you would work in concert with other State and local officials in putting together programs that would compete for a pilot project or two in this great State.

Governor THOMPSON. I mentioned our cooperative efforts with the State treasurer which has been ongoing for more than a year now. And I will continue, even though he and I are of opposite parties and we are both involved in statewide elections.

We put the interest of this State first. And if we can act together as State officials to advance the cause of the people of the State of Illinois, then we are addressing our statutory responsibilities, both the Governor and treasurer. We try to act across the board with particular emphasis on small businesses, both in trade and commerce and in agriculture as well because we can't ever forget that agriculture and agribusiness have long been economic mainstays of the State of Illinois and ought to continue to do so.

And we ought to be doing more in agribusiness and value added farm products.

One area that we need to encourage, we need to apply our labor to raw farm products in the State of Illinois and derive additional profit from them before shipping them outside our borders. There is no reason why the enterprise zone concept can't fit nicely with that desire on our part to expand and diversify our agriculture business as well.

As far as local government is concerned, I worked closely with the mayor of the city of Chicago and other mayors around the State of Illinois. And politics plays no part.

We want to insure that the State government is doing everything it can to assist local governments to help itself to be a partner with the State called for to be a partner.

We are long gone from the days when local government was the stepchild of the State, the stepchild of the State legislature. Home rule freed cities from bondage in other areas. And on the whole, I think it has been a laudible experiment in Illinois.

But there is much that the State and local governments can do together to encourage economic success. It is clear that we both have the same goals. If Chicago prospers, the State of Illinois prospers. If Rockford prospers, the State of Illinois prospers. They are all part of this State.

And so it is not only my purpose but my duty to make sure that local communities within the State of Illinois are receiving the beneft of everything that we in State government can do for them.

Senator DIXON. Well, I thank you. As soon as you can, I want you to send me the report of your committee, the suggested legislation and other things pertinent to this hearing. They will be placed in the record of the Small Business Committee and be part of the Senate record with regard to support for this legislation. [1]

And I also was interested in one other thing you mentioned, the question of some type of debenture for startup capital.

It is the view of this Senator, not necessarily all Senators, but certainly the view of this Senator, that for businesses to begin in these enterprise zone areas, in many cases you are going to have some front money to do the job. I am intrigued by the fact that you have recognized this as well, and welcome whatever you might suggest that is a product of your committee which addresses this problem. I would greatly appreciate if you could send us this information.

Governor THOMPSON. I think we have to recognize there is a confluence of events working in the Congress and the National Administration now in other areas which impact on these matters. The desire of both the President and Congress to reduce the Federal deficits in an effort to bring down interest rates which are strangling our economy, hurting retail and heavy machinery and hurting the automotive and agricultural industries is imperative.

And all of us will, I think, if we see that cuts are coming across the board, support the Congress in an effort to reduce the Federal deficit so long as we Governors and mayors and county executives see that cuts are being fairly applied across the board to all areas of the Federal budget.

We may realize that bottom line if we get the deficit down and get the interest rates down. If we don't, we can forget about talking about new businesses in the United States.

But we have to carefuly target our actions as well. And one of the perplexing areas, frankly, for me and I know for you and the Congress as well, is the issue of the tax-free bond. Until now the Federal Government has been relatively generous in encouraging local government and State governments to use tax-free bonds as an effort to stimulate economic development. And there is no doubt that some State and local governments and commercial enterprises have gone too far in the use of revenue of IDB and ready revenue bond concept. And it has to be decided in terms of what kind of tax incentives we are using.

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[1] Material not received at time of going to press.

Tax, first of all, ought to raise revenue and only ought to be secondarily instruments of social policy. And when they are instruments of social policy, they ought to get the job done in the most effective way.

I would only urge you, as I have the Illinois delegation before this, that you use your considerable prestige and influence within the Senate and within the House to clarify and discriminate between abuse of IDB and the proper use of IDB. Because we Governors believe that there is a proper place for that tax for certain financing. And we also recognize that we cannot continue to rely forever on that as a sole source of risk capital for small businesses in or out of enterprise zones.

And we in the States have a responsibility. We are working aggressively in that. Illinois is a leader among the 50 States.

We have interested the Midwest Governors Conference in doing that. That was our No. 1 priority this year, and we are accomplishing that.

We understand that there has to be a partnership and we are encouraging outside pension funds, both of business and labor, toward that goal. Again, it is one dimension of what we in Illinois feel must be a larger partnership between the business, labor, government and university community if any of this is to succeed.

But I did want to put in one small plug for that concept which has worked for the most part well. Please don't take it away from us. Clean it up. It needs to be cleaned up. But don't take it away from us.

Senator DIXON. As you know, I am a cosponsor of legislation to continue IDB's. And I share with you the view that we have to clean up our act, but I appreciate your remarks and I thank you very much for coming here today, Governor, and giving us the benefit of your point of view.

We will thank you in advance for the information that you will send either to me personally or my staff, and we appreciate very much your coming.

Mr. Sklavanitis, I thank you on behalf of this committee, Chairman Weicker, and the ranking Senator on our side, Senator Nunn, for coming here on behalf of Mayor Jane Byrne. May we have your title?

STATEMENT OF MR. SKLAVANITIS, COMMISSIONER, DEPARTMENT OF ECONOMIC DEVELOPMENT, CITY OF CHICAGO, ILL.

Mr. SKLAVANITIS. I am commissioner of the Department of Economic Development of the City of Chicago. I am here and I have brought with me prepared remarks which I will read precisely as it is prepared and in the context as if the mayor would have delivered this statement herself this morning.

Thank you, Senator Dixon. I greatly appreciate this opportunity to appear before you this morning to offer my thoughts about enterprise zones and the best ways this concept can be used to foster increased small business development in this country.

I believe the enterprise zone concept can be a worthwhile tool for stimulating business and economic revitalization. It is not a total solution by any means, but if properly drafted and implemented, I believe the concept can be of assistance.

As many of you know, I met with the President and many of his key advisors earlier this year to discuss the issue. I also know he has talked to other city officials and business leaders. I know he listened because the enterprise zone package sent to Congress late last month incorporates many of the suggestions that have been brought to his attention.

Let me take a few minutes to underscore some of the comments I made to the President.

First, I believe we must be very careful when considering any relaxation of municipal regulations. In Chicago, our zoning, building and health codes were put in place to protect the health and welfare of our citizens. Any wholesale revisions of these codes in the name of economic revitalization could ultimately do more harm than good.

Some modifications or variations are possible. We recently approved a new rehabilitation code that provides some flexibility for people who want to rehab older buildings. I believe the same thing could be considered if an enterprise zone is approved for Chicago. But, I cannot endorse signing a blank check in this area.

Next, I believe the Congress must be given some attention to the issue of capital formation. This is usually one of the most critical concerns facing the small businessman. Certainly, the fact that the President's proposal allows the use of urban development action grant loans and industrial revenue bonds is recognition that help is needed. But, I believe we must go farther in this area. Perhaps the Congress should consider making the tax breaks envisioned under this plan refundable or to be used to create a special venture capital loan pool solely for businesses started in enterprise zones.

Let me also suggest that if the administration in Washington expects local tax relief and infrastructure improvements to be provided for these zones, some consideration must be given to special allocations of community development block grant funds or special consideration of UDAG applications for enterprise zone projects. I am not trying to take a program that is rooted in the concept of limited government involvement and change it, but I believe this question must be addressed. For instance, the fiscal year 1983 budget proposals contain the same level of funding for block grants as fiscal year 1982. However, Chicago can expect to receive 12 percent less in fiscal year 1983 for a variety of reasons. If we are expected to make local tax cuts and make basic street, water and sewer improvements, than I believe it is only fair to suggest that the Federal Government absorb some of the cost. I note that both the President's proposal and some versions of State enterprise zone legislation I have seen call for a time consuming local, State, and Federal review process. I believe the city of Chicago knows which areas will qualify under the enterprise zone proposals and can quickly evaluate individual proposals. I question whether there needs to be lengthy reviews by the State and Federal levels before businesses can get started.

Finally, I believe we must give great attention to the job training needs of those who live or work in these zones. If this program is to truly help distressed areas, we must be especially eager to provide comprehensive training services. Here again, I believe special allocations of CETA-type funding might be beneficial to cities awarded enterprise zones.

I want to make a closing comment about who should be providing many of these public programs and services. Some enterprise zone proposals call for the creation of neighborhood enterprise zone associations to do many of the things that local government now does. The implication is that local government has failed. I reject that. I believe, that while new or existing community groups can be strong allies and partners, the bulk of the efforts to coordinate services must be left with city governments because the citizens and businesses in the zones ultimately will hold city governments accountable for the delivery of services.

In Chicago, we can be flexible and innovative. If cities have not appeared that way to the Federal Government, it might be because they have asked all cities to jump through the same hoop.

Enterprise zones can be a great help, and in Chicago we are interested in working to develop the legislation for them and implement it. Thank you.

Senator DIXON. I very much appreciate your remarks. The mayor has personally contacted me on a number of occasions to discuss with me her support for the basic concept here. Some of the things she has said in the statement, I think, are important contributions to the larger picture of what we should consider in reference to the communities' need in supporting this kind of a project.

I think it is worthwhile that she suggests that when we call upon the city to do more while giving the city less, there is a dichotomy there that is worthy of examination. And, that will all be in this record. It will be part, I am sure, of the discussion that takes place in the committee.

Now, it is fair to say, I think, that this comes within your purview as commissioner for economic development of this great city.

Mr. SKLAVANITIS. Yes, sir.

Senator DIXON. I know you were here when I discussed with Governor Thompson, the fact that in its concept it would be a pilot project of limited scope over a brief period of years while we will study it and see whether it is worthy of being a major undertaking of the Federal Government, working in collaboration with the State, the community, and the neighborhood groups. That is the whole concept here.

I think it is fair to say, is it not, that the mayor and others in your office here would work to make a contribution on behalf of this great city to obtain a project for this city, if it is at all feasible?

Mr. SKLAVANITIS. Senator, we are most anxious to participate in the program. As you have pointed out, it is a pilot effort. And, we would approach it on that basis.

Let me share some of my points of concern and opinions with respect to that. And, that is that I think, many people throughout the country are looking at the program as though the program itself may suddenly come in and begin to accelerate development investment in the areas where they are desperately needed to such an extent, that we might start to draw attention away from some of the other services and needs that are prevalent.

We are looking at it as a pilot venture. We have been studying and looking at the demographics of the city of Chicago. We have provided the U.S. Department of Housing and Urban Development some of our thoughts to their planning office as to the type of criteria that might be looked at in establishing eligibility for such zones.

And Chicago, I think it would be safe to say, that there might be several areas that would qualify. And, I could see where again, if I might emphasize local government involvement, it would be very important for the city of Chicago to be a main partner and for the legislative body of the city, the city council, to be involved in the determination of areas of eligibility and where the city might first propose such a zone to be established, because there are many zones. There are obviously going to be competing areas of the city for such a designation. And, I think we want to be very careful in the selection of the zones where the need is quite clear and where the criteria would be prevalent that the Federal Government would be looking at.

Senator Dixon. I might interrupt to say that I have seen, although, I will not reveal it here because we don't want to get into a neighborhood argument, but I have seen several suggestions at the community level here of where enterprise zones might be well placed.

One of the things I noted was that in your concept there was a larger zone than the administration apparently perceived it to be in the legislation under consideration. I would appreciate any thoughts you could give us for the record regarding what you think an appropriate size for a zone might be.

But, there seems to be some difference of opinion about the size of the zone. And to the extent that you can do that, and, of course, we both understand that a city could really have more than one zone, the fact is that the President's proposal is for only 25 for the country in each of the 3 years of the pilot program, and it makes it unlikely that any one place is going to have very many. But it is clear, you could have more than one.

Mr. Sklavanitis. I think you are quite right in that respect, Senator. We certainly are looking at it from the aspect that since Chicago is a home rule municipality, it is conceivable that Chicago might suggest at least locally that more than one area be designated. Now, whether or not the Federal Government would participate in more than one area, that is something yet to be considered.

But certainly, we are looking at several areas of the city that we see are areas that might be attractive for development investment. And certainly, there is a great need.

I think the Governor had mentioned the west side. I think there are some other areas of the city that are worth looking at.

Senator Dixon. One of the things that I have always admired so much about Chicago is the retention of the neighborhood concept here. It is a unique thing in big cities, and an element of value. When you entertain the thought of an enterprise zone concept in which the Federal Government, the State and local communities, and then the neighborhoods work together, it fits nicely in the Chicago scheme of things and is something that relates well to the concept envisioned in this legislation.

Mr. Sklavanitis. I believe that is extremely important, Senator, particularly if I might just add one of the points in the mayor's statement with respect to responsibility. I think that we need to continue a very close working relationship with the neighborhoods, with the neighborhood organizations and community organizations, the industrial councils that do exist throughout the city of Chicago. They have been very important to us and are very instrumental to us in the projects and programs that we are currently involved in with the department of economic development.

I think it is important to bear in mind there are some types of public services such as where police powers are being exercised that one need be very careful when one begins to say those types of powers might be turned over to a community-based organization.

The same holds true with basic housekeeping services such as streets and sanitation services. There might be areas where we know Federal support has been waning. Lately in the human services areas, such as the provision of day care facilities, if the private sector and local organizations might be able to participate more directly, particularly the private sector and provide some of those types of incentives, that should be encouraged.

Senator Dixon. Well, Commissioner, let me tell you how greatly we value your contribution and your fine mayor's contribution. Please express to her my warmest regards and tell her we appreciate this contribution.

We would welcome from you anything further that you would like to place in the record, either from the mayor, yourself, or members of your departments.

For instance, you talked about the need for startup money, an element that is vital if this concept is going to succeed, and it is something we have to address. There might be some differences of opinion among the Senators, but at least this Senator feels it is vital

Whatever suggestions you might have on the question of an outright grant, the question of bonds which I imagine is more attractive, or anything of that character would be welcome by the committee.

Mr. Sklavanitis. We will be glad to submit that for the record.[1]

Senator Dixon. I want to now say that on the first panel I neglected to mention one of the names. But I will do it as I read their names: Mr. Maynard Wishner, president of Walter E. Heller & Co.; Mr. David Leavitt, president of UNR-Leavitt Industries; Mr. Edwin Crego, Consult, Ltd., and Mr. David A. R. Dullum, president of Frontenac Capital Corp. I apologize, Mr. Dullum, for not mentioning your name earlier.

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[1] Material not submitted at time of going to press.

STATEMENT OF MAYNARD I. WISHNER, PRESIDENT, WALTER E. HELLER & CO., EXECUTIVE VICE PRESIDENT, WALTER E. HELLER INTERNATIONAL CORP.

Mr. **Wishner**. I am Maynard I. Wishner, president of Walter E. Heller Co., and executive vice president of Walter E. Heller International Corp., which is a $6,250 billion asset company with a substantial commitment to the small- and medium-size businesses it serves. It provides lending and other financial services to this segment of the business community through its banking subsidiary, the American National Bank in Chicago, through its overseas factoring network in 24 countries, and through its domestic commercial finance, factoring, equipment leasing and mortgage banking companies with 68 offices in the United States.

As part of this commitment, Heller has created the Walter E. Heller International Corp. Institute for the Advancement of Small Business Enterprises. The core of this activity is an 11-member policy study committee, which representation from business, labor, and major schools of business which have an interest in the status of small businesses. It is chaired by Dean Donald C. Carroll of the Wharton School.

One of its first contributions to the field of improving the environment within which small business operates was its policy paper on tax incentives for small business written by Dr. Hans Stoll and Dr. James Walter, of the Wharton School. This study directed toward the tax treatment of small businesses generally described some of the unintended discriminatory effects of existing tax rules and advanced suggestions that would aid the small businesses of the country with respect to one of their most difficult problems, the attraction and retention of capital.

We have already proposed that serious consideration be given to the merit of these recommendations over the total spectrum of small businesses. Now we ought aggressively to seek to at least make them applicable to the special category of enterprise zone companies. Clearly useful as investment incentives consistent with the objectives of enterprise zone legislation, their adoption in this context would also provide a laboratory for observing their effect in this special case to better understand the workings and impact of such devices.

Incentives in the form of tax benefits to the operating company itself suffers from the fact that newly formed businesses are not wallowing in profits which need to be sheltered to help finance additional growth. Thus, the emphasis in the administration's bill on tax credits would only be helpful to larger, profitable companies which it is hoped would be induced to undertake enterprise zone operations.

Relatively little is offered in the tax area for startups. One of the most serious problems for these new companies is the attraction of equity and debt investment.

Senator **Dixon**. If I may interrupt at that point. This is precisely my concern about the existing legislation. In fact, it isn't a very great value except to an established business that can take advantage of the tax laws. It doesn't encourage new businesses.

Mr. **Wishner**. If you apply that thinking to the plight of small businesses generally, you would be right in keeping with the kind of thinking that the distinguished professors went into in their development of the approach to the consideration of small businesses generally.

Full passthrough of tax losses are available under subchapter S corporations to individuals only up to their investment at risk in the company. Larger corporations with numerous subsidiaries are able to consolidate tax reporting and fully offset losses of one subsidiary against the income of the other even though the parent has not guaranteed the debt of the sub and is not at risk. We thus have what is in effect discriminatory tax treatment of small businesses generally, which ought to be removed as we seek to develop special incentives for enterprise zones.

The administration's bill provides for a 3- to 5-percent investment tax credit for investments in personal property in enterprise zone areas. Since it is frequently suggested that businesses which will locate in these zones are apt to be labor intensive, heavy equipment investment may not be a common characteristic of these concerns.

An investment tax credit for an investment in an enterprise zone operation, irrespective of how that investment was used, would provide a more direct incentive. The removal or modification of the at risk limitation could provide an additional magnet, not by special treatment and subsidy, but simply by making the rule in effect the same for the free-standing new business as it is for the subsidiary of a larger company.

One can foresee that one of the most serious difficulties enterprise zone businesses will face is that of attracting debt investment.

The operation of government guarantee programs has not established a record which would suggest a role for such activities in enterprise zones.

If the private lending sector is to be attracted, it will have to perceive a sound relationship between risk and reward. Traditionally, degrees of risk are reflected in the cost of credit up to the point where risk is perceived as so great as not to be justifiable at any obtainable rate of compensation.

An investment tax credit given directly to lenders to zone businesses helps to scale down the amount at risk, and, therefore, the risk itself. We could produce situations where this device could make the difference between a lender's "no" or a lender's "yes." We should expect cases where credit will be made available at prevailing, rather than at premium, rates because of this risk reduction. We might even see cases where the risk perceived by the marketplace in relation to the true, after tax credit exposure is such that rate concessions below those more generally prevailing might be available to further help nurture the prospects for the enterprise.

Devices to allow some degree of exclusion by the lender of interest income from its taxable income on interest paid by a zone enterprise can also make a contribution to the risk reward equation lenders will take into account as they consider the needs of these businesses.

Senator **Dixon**. You mean all together?

Mr. **Wishner**. I used the phrase "some degree."

Senator **Dixon**. Some percentage on the interest earned in an enterprise zone would be tax free?

Mr. **Wishner**. It is comparable to the IRB concept. If the IRB for these zones, as envisioned by the administration is perceived as a legitimate device, why limit the type of loan that can have the benefit of this treatment just to what happens when you go into a piece of real estate when there are other investments these businesses may have to make.

It is a distinction that is far too narrow in terms of all the kinds of assets that need to be employed, and all the expenses that need to be incurred. If the device is legitimate and attractive to a lender on real estate, why isn't it legitimate for a lender on the receivables or subordinated capital forms of lending devices. If it is legitimate in one area, we should be looking at what is so special about real estate when the needs of these enterprises will embrace more than the buying and rehabilitation of a plant and possibly installation of equipment.

An alternative to consider is permitting zone firms unable to use an interest deduction because of operating losses to pass that deduction on to the lender. Such a provision would also help remove an element of tax discrimination between profitable and unprofitable enterprises.

I have not addressed the general subject of the desirability or prospects for success of enterprise zone legislation. The degree of support such proposals have generated suggests we are going to get some kind of zone program. Certainly conditions characteristic of our depressed areas are such as to call for our best thinking of how to deal with a major national problem. No one approach will solve this problem.

The challenge to Congress and the administration is to do the best that can be done in framing a bill which is rooted in our current political reality and provides all the incentives which can responsibly be developed and applied. The zones to be designated and the people who occupy them have need for more than the development of indigenous businesses. As we embark on this trial of something new, we ought not to tell ourselves or tell our citizens that we have in one stroke at last found a solution to the problems of our inner cities. Perhaps enterprise zones can make a contribution, but we ought to not raise expectations to a level that will not be achieved or rest from the responsibility to continue to seek other means to break the pockets of need, decay, and disillusionment for which our country continues to pay a high price.

Senator **Dixon**. I thank you for your valuable testimony, and also for the cautious nature in which you have concluded your remarks. I hope we are not trying to oversell this product as the solution to all of our community ills. Clearly it is not.

As you have pointed out so very carefully in your remarks, it is a suggestion for ways to deal with the problems we have. And I hope there can be found a valuable one in time with the good work and the contributions of men like you in matters of this kind.

I was intrigued with the part of your testimony about the lender taking advantage of the loss carryover of a new business. In there any precedent for that in our tax laws now? You know that a profitable company and an unprofitable company under safe harbor leasing can take advantage of a similar arrangement. But I don't know of anything exactly like you are suggesting.

Mr. **Wishner**. Well, the analogy is the profitable company and unprofitable subsidiary. That means that a profitable company can continue to nurture a subsidiary and endure some losses for a period of time in the initial period. And the expenses incurred, including interest on the debt that is created to make possible the investment, becomes setoff against the other income. It is used. There is an economic benefit from the tax benefit, from the tax loss.

The freestanding startups are not in the same position to take advantage of that tax sheltering of the expenses. That tends to be discriminatory on the ability of the entrepreneur or group of people getting together to start a business.

There is kind of equity in trying to find a way in making the rules of the game as easy for the startup operation. Who stands in the place of the parent who is seeding its subsidiary with capital, with loans? It is the lender. He may be a third party lender, but he is doing it.

He doesn't have the support of a more profitable parent to which he is really looking as he is making his loan. And perhaps equalizing that treatment and creating an additional benefit for the lender under these circumstances may cause lenders to develop a whole different approach to risk-reward ratios, to his incentive for going in and saying I am going to take a chance. I like these people and I like their product. It is soundly conceived and I want to cooperate with the enterprise zone concept. They are going about it the right way and I can justify using these funds entrusted to me as a fiduciary. I can justify to my shareholders the use of these funds, if the net exposure in being wrong is reduced by this special package of incentives.

Absent that kind of thing, it is very difficult to see how a lender is going to be able to rationalize an exposure except on a do-good basis.

He may want to be a good citizen, but being responsible for assets to the Federal Government, the FDIC, the Federal Reserve bank, shareholders and depositors, it has to be a soundly conceived loan.

If we can leave the decisionmaking as to the risk to the risk taker, but modify that risk through some of these benefits, which are consistent with what others get in another kind of structure, perhaps we would add another kind of inducement. May I give you an illustration?

Senator **Dixon**. I wish you would.

Mr. **Wishner**. Suppose the enterprise has need to install equipment. Now that equipment has to cost $100,000, where do you get the money?

A lender can't lend $100,000 against that equipment. The moment it becomes installed, it is not worth the $100,000. But if through some of these consistent tax shelter devices, an investment tax credit is immediately available, the lender can say to himself "my risk exposure in this loan I am asked to make is no longer 100 percent, it is down to 80 percent." I have some benefit from this as

I compare this request with what I am willing to do in a nonenterprise zone. I can justify it as something sound.

Senator DIXON. Very good. I thank you for your very nice contribution to what we are undertaking here.

Mr. Leavitt, I am glad to have you with us this morning.

STATEMENT OF DAVID S. LEAVITT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNR INDUSTRIES, INC., CHICAGO, ILL.

Mr. LEAVITT. Mr. Chairman, my name is David Leavitt and I am president and chief executive officer of UNR Industries, Inc. UNR Industries is a diversified company which had approximately $350 million worth of gross sales last year. And I want to thank you for the opportunity to appear before this committee concerning the Urban Jobs and Enterprise Zone Act. The act encourages interaction between Government and the private sector in the economic revitalization of our cities.

I am convinced that the urban enterprise zone cannot only be a powerful tool for the economic rebirth of our inner cities, but also that it will stimulate their further development and lead to their economic stabilization. It will offer to the residents of areas in and near the enterprise zone a rebirth of hope, providing them with the occasion to participate in a new and challenging opportunity through the creation of jobs.

I would like to relate to you the background of my company's decision to locate its new plant in Chicago's southside. UNR's story illustrates the potential and the problems of current laws and procedures.

UNR Industries is a diversified company which last year had gross sales of approximately $350 million. The largest unit of UNR is the UNR-Leavitt Division, manufacturers of welded steel tubing. For over 25 years, UNR-Leavitt has operated a tubing plant on the south side of Chicago. In the mid-1970's, the company decided to construct a new plant for the manufacture of a large structural tubing to serve the growing market for this product.

We seriously considered Chicago as well as Columbus, Ga., and Birmingham, Ala., as sites for the plant. Georgia in particular offered several advantages. UNR-Leavitt was able to purchase at a very favorable price a parcel of land for constucting the new plant. It had a low-cost labor market and access to developing markets for large structural tubing in the southeastern part of the United States. And the State offered a possible opportunity to finance the land through the use of industrial development bonds.

We opted for Chicago, however, because the city offered several incentives to induce us to locate the new plant there. The major incentives were:

First, A loan from the city at low interest over 20 years, funded by a Federal UDAG grant.

Second, a UDAG grant to the city of Chicago of $2 million to upgrade the streets and public works in the surrounding area.

Third, most importantly, the city, through the Chicago Regional Port District, agreed to seek foreign-trade zone status for the UNR-Leavitt facilities in Chicago, allowing the manufacturing of tubing on a duty-basis equivalent to that enjoyed by foreign manufacturers of tubing with whom UNR-Leavitt competes.

The city government and related agencies have worked diligently to secure these promised advantages. In particular, Wilson Frost, the alderman in the area of our plant, has labored tirelessly, and Charles Sklavanitis of the city of Chicago Economic Development Commission and his assistant, Myron Louik, and Frank Martin of the Chicago Regional Port Authority which allowed us to remain in the city of Chicago.

We sought foreign-trade zone status because it presents us with an opportunity to manufacture products in the United States which can complete on equal terms with foreign products. The city has supported the project, and we have increased production in our plants and will create jobs.

Many foreign-trade zones create American jobs by encouraging the manufacture of finished products for sale in the United States or for export which for customs reasons might otherwise be manufactured abroad. Thus, a major benefit of the emerging concept of foreign-trade zones with that of enterprise zones would be to concentrate industrial development in areas of high unemployment.

The two ideas are natural complements. The proposed foreign-trade zone for UNR's facility is located among four neighborhood communities in Chicago which display much evidence of economic decline. The area is characterized by business closings, a declining industrial and economic base, deteriorating streets, declining public services, chronic unemployment, poverty, and high welfare dependency. We believe that through economic stimulus that would be provided by increased production at UNR-Leavitt under foreign-trade zone status, this trend of poverty and unemployment can and will be reversed. The manufacturing jobs created by reason of a foreign-trade zone would have a multiplier effect in local service employment, not only in the zone itself, but also in adjacent communities.

The increased manufacturing output will create also a demand for locally supplied materials, equipment and services. The restoration of local rail service in the community by the LaSalle & Bureau County Railroad influenced UNR's commitment to use rail services in connection with the plant. Also, the increased economic base resulting from the foreign-trade zone will provide an attaction for businesses considering location in that area. This would in turn assist the inner city in its efforts to attact new infusions of private capital into the city's poorest areas.

Through the creation of foreign-trade zones in places of high unemployment such as enterprise zones, businesses would have the opportunity to harness the forces of the marketplace rather than spending Government funds in bringing about the revitalization of urban areas in the throes of serious decay.

The urban enterprise zone bill also refers to the application process for the designation of a foreign-trade zone in an enterprise zone. I strongly support the language which calls for an expeditious application process. We still await a decision after nearly 2 years.

Finally, the bills will provide a measure of coordination of effort to obtain incentives for the development of business in urban enterprise zones. A small businessman seeking to locate in a blighted area which involves economic risk will be dissuaded from doing it if he faces an additional prospect of many months of frustrating applications, meetings and procedures without firm assurances of a favorable outcome.

One of the beneficial effects of the bill, in my view, will be to allow the businessman to know with great certainty that if he locates in the zone, he will obtain certain enumerated benefits with a minimum of regulatory complications.

This will considerably enhance the attractiveness of the urban enterprise zone area of the small businessman.

Mr. Chairman, thank you for allowing me the opportunity to testify before the committee. And I will be happy to respond to your questions.

[The prepared statement of Mr. Leavitt follows:]

TESTIMONY OF
MR. DAVID S. LEAVITT
PRESIDENT, UNR INDUSTRIES, INC.
BEFORE THE SENATE COMMITTEE
ON SMALL BUSINESS
CHICAGO, ILLINOIS
APRIL 7, 1982

Mr. Chairman, my name is David S. Leavitt and I am President and Chief Executive Officer of UNR Industries, Inc. I would like to thank you for the opportunity to appear today before this Committee to speak on behalf of the passage of the Urban Jobs and Enterprise Zone Act. The Act encourages interaction between government and the private sector in the economic revitalization of our cities.

I am convinced that the Urban Enterprise Zone can not only be a powerful tool for the economic rebirth of our inner cities; but also that it will stimulate their further development and lead to their economic stabilization. It will offer to the residents of areas in and near the enterprise zone a rebirth of hope, providing them with the occasion to participate in a new and challenging opportunity through the creation of jobs. Thus, it will create a new sense of pride and achievement in the residents of those areas that are now euphemistically referred to as "blighted."

While the bills will foster the renaissance of our inner cities, they will also lay the groundwork for their prolonged success. The more the zones prosper, the more success they will breed. A thriving zone, with many of its residents actively participating in economic improvement efforts, is certain to attract new business and new residents.

I would like to relate to you the background of my company's decision to locate its new plant in Chicago's South Side. UNR's story illustrates the potential and the problems of current laws and procedures.

UNR Industries is a diversified company which last year had gross sales of approximately $350,000,000. The largest unit of UNR is the UNR-Leavitt Division, manufacturers of welded steel tubing. For over 25 years, UNR-Leavitt has operated a tubing plant in the south side of Chicago. In the mid 1970's, the Company decided to construct a new plant for the manufacture of large structural tubing to serve the growing market for this product.

There were obvious advantages to putting the new plant adjacent to the existing one, relating to effective management and consolidation of shipping and receiving operations in one location. However, there were also significant advantages to locating outside the city, and our initial plan was to locate the plant in Columbus, Georgia.

Georgia offered several advantages. The local government sold UNR-Leavitt, at a very favorable price, a parcel of land for constructing the new plant, and helped rezone this land.

The Georgia facility also offered a low-cost labor market, and access to developing markets for large structural tubing in the southeastern part of the United States. The State additionally offered an opportunity to finance the plant through the use of industrial development bonds.

When the City government of Chicago learned of our plans to build the new plant, they were quite interested in having us build it in the City of Chicago to create several hundred new jobs. The area in which the original plant, and now the new plant, are located is one which has suffered from severe economic decline over the past decade and more. Minority population and unemployment have gown considerably, and income and housing have declined. In short, the area would appear to qualify as an Urban Jobs and Enterprise Zone. Several incentives were offered to us to induce us to locate the new plant in the city. Major incentives were:

1. A loan from the City at low interest over twenty years, funded by a federal UDAG grant. Ten million dollars was sought under this loan program, of which one million was received by UNR. The proceeds were used to purchase capital equipment.

2. A UDAG grant to the City of Chicago of $2,000,000 to upgrade the streets and public works in the surrounding area.

3. Most importantly, the City, through the Chicago Regional Port District, agreed to seek foreign-trade zone status for the UNR-Leavitt facilities in Chicago, allowing the manufacturing of tubing on a duty basis equivalent to that enjoyed by foreign manufacturers of tubing with whom UNR-Leavitt competes.

The City Government and related agencies have worked diligently to secure these promised advantages. In particular, Wilson Frost, the Alderman in the area of our plants, has labored tirelessly to secure these promised advantages which allowed us to remain in the City of Chicago. Charles Sklavanitis of the City of Chicago Economic Development Commission, and his assistant Myron Louik worked extensively on the UDAG applications and on the foreign-trade zone application. Frank Martin, General Manager of the Chicago Regional Port District, which is the grantee of the Chicago foreign-trade zone, has also worked to secure this essential benefit for the creation of additional employment at our plants. On the Federal Government side, Mr. William Hammer, the Senior Development Director at the Department of Housing and Urban Development, handled the UDAG applications.

As you are aware, foreign-trade zones are secured, enclosed areas within the U.S., but considered outside the Customs territory of the U.S. They are operated as public utilities by qualified corporations, and they function under Customs supervision. Both foreign and domestic goods may be moved into foreign-trade zones for a variety of operations ranging from storage or exhibition, to assembly or manufacture. If the foreign goods are entered into the U.S., then there is a Customs duty which may be levied either on the original foreign materials or on the finished product. Domestic goods moved into a foreign-trade zone may be considered exported upon entering the zone.

I should note also that foreign-trade zones are not solely or even primarily designed for exports. Many foreign-trade zones create American jobs by encouraging the manufacture of finished products to be sold in the United States or for export which, for Customs reasons, might otherwise be manufactured abroad. The importation of large structural tubing is encouraged by the U.S. tariff structure, which imposes much lower duties on finished tubing than on the raw materials (steel plates and sheets). The foreign-trade zone will allow UNR-Leavitt to compete on equal terms with foreign tubing manufacturers, substituting American-made tubing for foreign products, and creating American steel workers' jobs.

The recent rapid growth in foreign-trade zone development demonstrates that industry, and especially those concerns involved in manufacturing and distribution, realize the potential of utilizing foreign-trade zone procedures in their operations. A major benefit of merging the concept of foreign-trade zones with that of Enterprise Zones would be to concentrate industrial development in areas of high unemployment. The two ideas are natural complements. Industrial growth is of extreme importance in helping reach the inner city residents by creating a large number of new jobs.

The proposed foreign-trade zone for UNR's facilities is located among four neighborhood communities in Chicago which display much evidence of urban economic decline. The area is characterized by business closings, a declining industrial and economic base, deteriorating streets, declining public servies, chronic unemployment, poverty and high welfare dependency. Perhaps the most telling statistics are those concerning unemployment and welfare dependency. According to the Northeastern Illinois Planning Commission, unemployment in that area reached an average level of 13.4 percent in 1980, which was almost double the national average level of unemployment at that time. Fully 22 percent of the local population was on the welfare rolls. These figures have undoubtedly gotten worse in recent months.

We believe that, through economic stimulus that would be provided by increased production at UNR-Leavitt under foreign-trade zone status, this trend of poverty and unemployment can and will be reversed. This would be done through the creation of new jobs, and by the infusion of substantial amounts of money into the local economy through wages and payment for services. The company currently maintains only two shifts of workers at this facility. A third shift would be employed under conditions of full capacity utilization resulting from zone status. The incremental employment resulting from full capacity utilization would mean that 269 additional jobs in the area would be added. We have estimated that the dollar value of the direct incremental employment at the zone would be over $7 million in employee wages, bonuses and benefits annually and $34 million in payments for services and supplies.

However, not only those persons directly involved with the foreign-trade zone would be the beneficiaries. The manufacturing jobs created by reason of the foreign-trade zone would have a multiplier effect on local service employment not only in the zone itself but also in adjacent communities. Of course, additional workers would create opportunities for additional service employees in that area.

The increased manufacturing output will also create a demand for locally supplied materials, equipment and services.

The resurrection of local rail service in the community was due to UNR's commitment to use such services because of our new plant. The LaSalle and Bureau County Railroad has acquired the necessary track from the bankrupt Rock Island Line. The restoration of rail services has already helped the community by retaining Libby, McNeil and Libby's warehouse, which had been slated for closing by the company. Finally, the increased economic base resulting from the foreign-trade zone will provide an attraction for businesses considering location in that area. Business growth would, in turn, assist the inner city in its efforts to attract new infusions of private capital into the city's poorest areas.

The Urban Enterprise Zone bills represent a new approach to solving our urban problems by encouraging businesses to establish or retain facilities in the inner city, increasing employment and productivity there. I think these steps are needed. Under current laws, there are not enough incentives to compensate for the natural disadvantages of locating in inner city areas.

While the bills differ in some respects, all recognize the valuable contribution that foreign-trade zone designation can make to urban development. Through the creation of foreign-trade zones in the designated enterprise zones, businesses would have the opportunity to harness the forces of the market place (rather than government funds) in a joint effort of the federal government, local government and the private sector in bringing about the revitalization of urban areas in the throes of serious decay. I strongly believe that by incorporating the concept of foreign-trade zones with that of enterprise zones, we can accomplish that goal more effectively.

The bills also address the application process for the designation of a foreign-trade zone in an enterprise zone. I strongly support the language which calls for an expeditious application process. In our experience with the application process, we have found that the entire sequence, from the time the application is submitted to the time the Foreign-Trade Zones Board reaches a decision, takes an average of over six months. In our case, we still await a decision after nearly two years. I believe that there is too much time lost in this process, valuable time that can be put to productive use with the assistance of the Foreign-Trade Zones Board.

Finally, one of the beneficial effects of the bills will be to achieve a measure of coordination of effort to obtain incentives for the development of business in Urban Enterprise Zones. The process by which the necessary approvals for existing benefits have been handled in our case, and the uncertainty of the results, illustrate the need for further improvements in conferring redevelopment benefits, particularly if they are to help small and medium sized businesses which would like to locate in areas that need economic revitalization. For example, the UDAG loan which UNR received through the City of Chicago required over 18 months of herculean effort in dealing with the federal Department of Housing and Urban Development through the City of Chicago and the bank which was involved. A small businessman seeking to locate in an area of this type, which involved obvious economic risks, will be dissuaded from doing it if he faces the prospect of many months of frustrating applications, meetings and procedures, without firm assurances that the applicant will receive the advantages it seeks. The primary function of the Urban Enterprise Zone Legislation, in my view, would be to allow the businessman to know with greater certainty that if he locates in the zone, he will obtain certain enumerated benefits with a minimum of regulatory complications. This will considerably enhance the attractiveness of the urban enterprise zone area, especially to the small businessman.

Mr. Chairman, thank you for allowing me the opportunity to testify before the Committee. I will be happy to respond to your questions.

Senator DIXON. I thank you very much, Mr. Leavitt, for your coming here today. We appreciate your testimony.

I am going to take the liberty of excusing both and the prior witness who has been so kind as to wait so patiently for us.

I want to thank Maynard for coming here and making the fine contribution. Mr. Wishner and Mr. Leavitt, we thank you both for coming.

Mr. LEAVITT. Thank you, Senator, for allowing us to express our thoughts.

Senator DIXON. Mr. Edwin Crego of Consult, Ltd.

STATEMENT OF EDWIN T. CREGO, JR., PRESIDENT, CONSULT, LTD., CHICAGO, ILL.

Mr. CREGO. I think I will present a somewhat different perspective.

Good morning. My name is Ed Crego, Jr. I am here today to speak to you as the owner of a small business, Consult, Ltd., which does management consulting work in areas related to employment, training, economic and community development, and as an individual who invests in other small businesses.

I thank you for the opportunity to express my views on influencing small business investment in enterprise zones at this hearing.

Let me begin by stating that I think that the enterprise zone concept, as originally conceived, translated into various forms in several congressional bills, has considerable potential. However, I believe that if the concept is limited primarily to a program of tax relief, as advanced in the administration's proposal of March 23, that that full potential will not be realized.

In fact, a worst case scenario, if such a limited approach were implemented, would be that those areas selected to be enterprise zones could become known as economic twilight zones, officially designated distressed areas where the hopes and futures of small businesses, disadvantaged and unemployed individuals, and neighborhoods are held in a perpetual state of half-light, frustration, and abeyance.

There are certain realities that must be faced. This could occur because, as I see it, the proposed approach ignores certain basic realities. For example, an area selected to be an enterprise zone will most likely be characterized by an unskilled and uneducated labor force; high crime and poor security; deteriorating plants and buildings; erratic and inadequate public services; insufficient operating costs. This is hardly the type of place to excite even the most venturesome of investors or business people.

The reality that I think is ignored the most is what Governor Thompson said this morning. New businesses take a number of factors into account when going into an area. And tax incentives in and of themselves only address part of the problem.

I think that is something that has to be looked at in the total enterprise zone legislation. I think more than anything else, Mr. Wishner, commented on this. More than anything, small businesses need startup capital. People who are concerned on a day-to-day basis about meeting cash flow payroll, tax incentives aren't a great benefit to those individuals. Those individuals who are presently classified as disadvantaged or hard core unemployed lack both basic employability and job skills. They will not be seen as immediately desirable employees by those companies located in an enterprise zone. They need desirability development.

History has shown in our limited experiments with programs like the new jobs tax credit, the target jobs tax credit, that those tax incentives in and of themselves haven't been sufficient to encourage people to hire either the disadvantaged and those who have been unemployed for a relatively long period of time.

Other incentives I think are essential, especially within the zone, to make the zone work. As Mr. Sklavanitis indicated on behalf of Mayor Byrne, those older State and local governments containing the majority of the distressed areas which would be eligible to be designated as enterprise zones are already strained and overextended. They are allocating the Federal funds they received on a relatively equitable basis.

I think at this point to think that they could redistribute those funds to concentrate them in an enterprise zone at the expense of other parts of the States or other parts of the cities, that might be unrealistic.

While there may be existing neighborhood associations, community groups and small businesses in those areas to be designated zones, many of them will need considerable special help and assistance to enable them to participate productively in order to make the enterprise zone concept work.

And I think that is the point you made in you introductory statement, the need for management assistance or technical assistance. It is critical.

To sum up, the administration's proposal constitutes a recognition of the need for intervention in what is becoming increasingly more of a serious situation. Unfortunately, it addresses only a small part of the totality of the need and the reality of that situation. Therefore, in my opinion, this proposal should be modified to make it more substantive, comprehensive, and reality based.

My thoughts on what needs to be done are not exactly revolutionary. In fact, much of what I am going to propose will sound familiar. My basic premise, although I know it is contrary to the New Federalism, is that if enterprise zones are to work, the Federal Government must be willing to make a more substantial commitment, both in dollars and "sense" to them.

For the past 15 years, we have thought that the Federal Government could solve all of the societal problems in our distressed urban and rural areas. We have been wrong.

But we will be equally incorrect now if we think that the private sector represented by undercapitalized small businesses, collaborating with nearly bankrupt State and local governments, can become the mechanism to overcome past shortcomings.

The private sector simply cannot take over the Federal Government's responsibilities to solve domestic problems which are national in scope; nor can our States and localities.

What they can realize, though, in the enterprise zone, if that entity is properly structured and supported, is a true marriage between the public and private sector which can lead to significant problem-solving and positive results. If the Federal Government wants that marriage to be brought about and to bear fruit, however, it has to provide both parties to the marriage with powerful reasons for coming and staying together, and dowries to enable them to survive during the economic hard times inevitable in the first few years of their relationship.

My specific recommendations on actions that could be taken to increase the potential for zone success fall into four categories: small business incentives; employment and training incentives; economic, community, and neighborhood incentives; planning and development incentives.

Under the small business heading, I recommend increasing access to investment capital. I think that has been stated and related here many times, so I will just elaborate quickly on that.

The idea of allowing investors to deduct their entire investment up to some reasonable amount for a set number of years from their taxable income is something that can attract capital to the zone area.

The idea of restricting the concept of qualified leasing to businesses in zones so that those businesses can sell their credits and deductions to raise operating cash and reduce financing needs is good.

A third idea under investment capital is guaranteeing loans of financial institutions to zone businesses under an arrangement similar to the SBA's loan guarantee program.

Finally, there is furnishing special direct long-term low-interest loans to business in the zones.

Second, under the category of small business is direct monetary incentives for hiring the disadvantaged. Coming for the present bill, which has been pointed out in the Heritage Foundation in their analysis of the bill, I would recommend providing a significant partial wage subsidy, as is done now for CETA for a set period of time, 1 to 2 years, to those zone employers who add disadvantaged laborers to their payrolls. In effect, this subsidy would work to give the employer the advantage of paying below minimum wage out of its own pocket without harming the employee's wage stream.

Next is setting aside Federal contracts for zone businesses. Designate, through Federal regional offices, a specific percentage of dollar total of a given category of Federal contracts; for example, of a defense nature, and allow only those businesses in the zone to compete for them.

Next is refund tax credits to small businesses. Provide a means for small firms to recapture directly part of what they pay in income taxes, to pay for those beneifts of the investment tax credit which they would not be able to take advantage of if they were operating at a loss.

Under employment and training, I recommend subsidising the employment of community residents to improve the provision of public services in the zones.

Mr. Sklavanitis and I both alluded to the fact that the community groups can collaborate with the city, given the opportunity, in areas such as daycare, security, and catering.

Therefore, I would recommend instituting within the zones for a designated time frame the concept of public service employment. That may be a dirty word, but I think it has some potential if it is a restricted concept.

I would recommend setting aside nongovernment organizations and small businesses to provide services such as daycare and security within the zone. This should help to develop the community infrastructure and the stability necessary for economic growth and development.

Under employment and training, I recommend establishing zone employment training corporations in conjunction with the loal offices of the State employment service to help disadvantaged individuals prepare for, get and keep jobs. These corporations could enter performance-based contracts to handle intake, assessment, and employability development, job training, job development, and placement to insure that the disadvantaged get their share of jobs created in the zones.

With regard to economic, community, and neighborhood incentives, I recommend insuring neighborhood involvement in the zone through local economic development commissions. Another step I recommend under that heading is furnishing free technical assistance to zone business groups and associations.

Finally, under the heading of economic development, I also recommend some measure to promote local ownership of enterprise businesses and resources such as allowing local neighborhood groups to set up general stock option corporations which would be used to purchase land, buildings, and businesses in the zone.

This should make the zone a community venture and be an effective deterrent against exploitation of the zone by outsiders.

Finally, under the planning and development area, I recommend insuring clearly articulated linkages among all zone programs and enterprises. Mandate that the locality's plans for an enterprise zone tie together as many programs as possible and stipulate some minimum requirements as regarding things such as linkages, commitment of capital from local financial institutions, upgrading of public services, and State-level coordination and supportive actions.

My last recommendation should is there should be some mechanism to encourage innovation and creativity in zones through a competitive financial award process. I would recommend establishing a small number of financial awards to be given for 2- to 3-year periods, which zones and businesses within them can compete for on a periodic basis by submitting proposals.

In conclusion, it is my firm belief that if the enterprise zone legislation does not incorporate many of the foregoing features, the results will be dismal. The enterprise zone concept will become, as the Model Cities programs which have been so recently decried, just another unsuccessful footnote in the account of 20th century attempts at urban and rural economic redevelopment.

And, most sadly of all, as I stated earlier, those areas eligible for participation in the program will remain, at best, economic twilight zones, undisturbed in times of prosperity but further ravaged when times are bad.

Again, thank you. I would be happy to answer any questions.

[The prepared statement of Mr. Crego follows:]

CONSULT, LTD

ENTERPRISE ZONES OR "ECONOMIC TWILIGHT ZONES"?

STATEMENT BY
EDWIN T. CREGO, JR.
PRESIDENT
CONSULT, LTD.

BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
APRIL 7, 1982

307 North Michigan Avenue • Suite 1518 • Chicago, Illinois 60601 • (312) 346-1567
Chicago • Washington, D.C.

Good morning. My name is Ed Crego, Jr. I am here today to speak to you as the owner of a small business--CONSULT, Ltd., which does management consulting work in areas related to employment, training, and economic and community development--and as an individual who invests in other small businesses. Thank you for the opportunity to express my views on "Influencing Small Business Investment in Enterprise Zones" at this hearing.

Let me begin by stating that I think that the enterprise zone concept, as originally conceived, translated into various forms in several Congressional bills, has considerable potential. However, I believe that if the concept is limited primarily to a program of tax relief - as advanced in the Administration's proposal of March 23 - that that potential will not be realized.

In fact, a worst case scenario, if such a limited scope approach were implemented, would be that those areas selected to be enterprise zones could become known as "economic twilight zones" - officially designated distressed areas where the hopes and futures of small businesses, disadvantaged and unemployed individuals, and neighborhoods are held in a perpetual state of half-light, frustration, and abeyance.

REALITIES OF THE SITUATION

This could occur because, as I see it, the proposed approach ignores certain basic realities. Namely,

- An area selected to be an enterprise zone will most likely be characterized by an unskilled and uneducated labor force; high crime and poor security; deteriorating plants and buildings; erratic and inadequate public services; insufficient access to investor capital, and high operating costs. Hardly the place to excite even the most venturesome of investors or business people.

- New businesses make location decisions based upon a complex set of factors including wage rates; nature of the labor force; land and building availability and cost; access to capital; quality of the local neighborhood; community and government infrastructure; conditions of the immediate environment - its safety, security, and services; and availability of quality vocational education and training programs. Tax incentives address these factors only tangentially, and do little to offset the many negative characteristics that a new business might see in an enterprise zone area.

- More than anything else, small businesses need initial start-up and operating capital for their early years of existence. That money is very hard to come by. Tax loss carryforwards and accelerated depreciation schedules mean very little to the business person trying to meet cash flow and payroll requirements on a daily basis.

- Those individuals presently classified as disadvantaged or "hard core" unemployed lack both basic employability and job skills. They will not be seen as immediately desirable employees by those companies locating in an enterprise zone. These companies will need strong positive incentives to hire the disadvantaged.. History has shown that, in most instances, tax credits by themselves do not achieve this end. Other incentives such as job training, wage subsidization, and supportive services are essential.

- Those older state and local governments containing the majority of the distressed areas which would be eligible to be designated as enterprise zones are already strained and overextended. Good politics will dictate that those entities distribute the funds that they are getting back from the federal government either relatively equitably or in a manner predicated to favor most those groups or persons that can help them most. In either case, it is not likely that an enterprise zone can or will be given the preferential treatment in the distribution of governmental resources that is envisioned under the Administration's approach.

- While there may be existing neighborhood associations, community groups, and small businesses in those areas to be designated zones, many of them will need considerable special help and assistance to enable them to participate productively in order to make the enterprise zone concept work.

To sum up, the Administration's proposal constitutes a recognition of the need for intervention in what is becoming an increasingly more serious situation. Unfortunately, it addresses only a small part of the totality of the need and the reality of that situation. Therefore, in my opinion, this proposal should be modified to make it more substantive, comprehensive, and reality-based.

RECOMMENDATIONS

My thoughts on what needs to be done are not exactly revolutionary. In fact, much of what I am going to propose will sound familiar.

My basic premise - although I know that it's contrary to the new federalism - is that, if enterprise zones are to work, the federal government must be willing to make a more substantial commitment--both in dollars and "sense"-- to them.

For the past 15 years, we have thought that the federal government could solve all of the societal problems in our distressed urban and rural areas. We have been wrong. But, we will be equally incorrect now if we think that the private sector represented by undercapitalized small businesses, collaborating with nearly bankrupt state and local governments, can become the mechanism to overcome past shortcomings.

The private sector simply cannot take over the federal government's responsibilities to solve domestic problems which are national in scope; nor can our states and localities.

What they can realize, though, in the enterprise zone--if that entity is properly structured and supported--is a true marriage between the public and private sector which can lead to significant problem-solving and positive results. If the federal government wants that marriage to be brought about and to bear fruit, however, it has to provide both parties to the marriage with powerful reasons for coming and staying together, and dowries to enable them to survive during the economic hard times inevitable in the first few years of their relationship.

My specific recommendations on actions that could be taken to increase the potential for zone success fall into four categories:

- Small Business Incentives
- Employment and Training Incentives
- Economic, Community and Neighborhood Incentives
- Planning and Development Incentives

Small Business Incentives

Under the small business heading, I recommend:

- Increasing Access to Investment Capital
  Make it easier for small businesses in the zones to get capital by:

  a. allowing investors to deduct their entire investment, up to some reasonable amount, for a set number of years, from their taxable income.

  b. restricting the concept of "qualified leasing" to businesses in zones so that those businesses can sell their credits and deductions to raise operating cash and reduce financing needs.

  c. guaranteeing loans of financial institutions to zone businesses under an arrangement similar to the SBA's guaranteed loan program.

  d. furnishing special direct, long-term, low interest loans to business in the zones.

- Giving Businesses Direct Monetary Incentives for Hiring the Disadvantaged
  Provide a significant partial wage subsidy, as is done now for CETA, for a set period of time - 1 to 2 years - to those zone employers who add disadvantaged laborers to their payrolls. In effect, this subsidy would work to give the employer the advantage of paying below minimum wage out of its own pocket without harming the employee's wage stream.

- Setting Aside Federal Contracts for Zone Businesses
  Designate, through federal Regional Offices, a specific percentage or dollar total of a given category of federal contracts, e.g., of a defense nature, and allow only those businesses in the zone to compete for them.

- Refund Tax Credits to Small Businesses
  Provide a means for a small firm to recapture directly part of what it pays in income taxes, to pay for those benefits of the investment tax credit which it would not be able to take advantage of if it was operating at a loss.

Employment and Training Incentives

Under employment and training, I recommend:

- Subsidizing the Employment of Community Residents to Improve the Provision of Public Services in the Zones
Reinstitute, within the zones only, for a designated time frame, the concept of "public service employment" as it was described under Title II-D of the old CETA Act. Set aside funds so that neighborhood and community groups can establish non-profit organizations and small businesses to provide services such as day care centers, security, and catering. This should help to develop the community infrastructure and stability necessary for economic growth and development.

- Establishing Zone Employment and Training Corporations
Create, in conjunction with the local offices of the State Employment Service, corporations specially set up to help the disadvantaged prepare for, get, and keep jobs. These corporations could enter performance-based contracts to handle intake, assessment, employability development, job training, job development and placement to ensure that the disadvantaged get their share of jobs created in the zones.

Economic, Community and Neighborhood Incentives

With regard to economic, community, and neighborhood incentives, I recommend:

- Ensuring Neighborhood Involvement in the Zone through Local Economic Development Commissions
Require that neighborhood economic development commissions comprised solely of representatives from small businesses, unions, community representatives, financial, government, and educational institutions within the zone be established in each zone. These commissions should sign off on all plans for the zone. They should provide the vehicle at the local level to ensure that the zone is not exploited by speculators and does not become a low-cost harbor for large business relocation and tax avoidance.

- Furnishing Free Technical Assistance to Zone Businesses, Groups, and Associations
Support, through contracts with and mechanisms such as the Service Core of Retired Executives, universities, small businesses and other service providers, technical assistance to help those various entities within the zone to make a quick transition from dependence to self-sufficiency.

- Promoting Local Ownership of Enterprise Businesses and Resources
  Allow local neighborhood groups the option of creating general stock ownership corporations which can be used to purchase land, buildings, and businesses in the zone. This should make the zone a community venture and be an effective deterrent against exploitation of the zone by outsiders.

Planning and Development Incentives

Finally, with reference to planning and development,

I recommend:

- Ensuring Clearly Articulated Linkages Among All Zone Programs and Enterprises
  Mandate that the localities' plans for an enterprise zone tie together as many programs as possible and stipulate some minimum requirements regarding:
  - linkages among locally administered federal programs (e.g., economic, employment and training, housing, vocational education)
  - commitment of capital from local financial institutions
  - upgrading of public services
  - state level coordination and supportive actions.
- Encourage Innovation and Creativity in Zones Through a Competitive Financial Award Process
  Establish a small number of financial awards, to be given for 2 to 3 year periods, which zones and businesses within them can compete for on a periodic basis by submitting proposals. These awards could be used to support innovative activities and arrangements the zones themselves might undertake to stimulate and generate business, economic and employment opportunities, within the zone, and to finance the development of new products or services by zone businesses. An independent national panel should review the proposals and select the zones and businesses to be given these awards.

In conclusion, it is my firm belief that if the enterprise zone legislation does not incorporate many of the foregoing features, the results will be dismal. The enterprise zone concept will become--as the Model Cities programs which have been so recently decried--just another unsuccessful footnote in the account of 20th Century attempts at urban and rural economic redevelopment. And, most sadly of all, as I stated earlier, those areas eligible for participation in the program will remain, at best, economic twilight zones - undistrubed in times of prosperity, but further ravaged when times are bad.

Again, thank you. I look forward to questions.

Senator DIXON. I want to thank you, Mr. Crego, for that very helpful contribution to this hearing. I suppose one would have to observe that the probabilities of what you are suggesting becoming a reality are not good, particularly in present times.

On the other hand, there are a great many points you make here which I think are very valuable.

One I was intrigued by was your CETA suggestion, in view of the fact that the concept of CETA has fallen on hard times. I think this is largely because of the abuse of the programs in parts of the country and the perception that it isn't really training a person to do anything valuable as a permanent lifestyle or employment advantage for the future.

Your suggestion has some value here in the sense of employing a similar type program for the training of disadvantaged individuals in this private sector environment to give an employee a true opportunity to exist in a permanent employment situation in the future.

That is worthy of note.

I would ask you to give a copy of your statements to the committee and further to make anything available to us in the future by sending it directly to me or giving it to anyone in our Chicago office here to be forwarded to Chairman Lowell Weicker of the Small Business Committee.

Mr. CREGO. I would be happy to do so, and I would be very happy to recognize the fact that we should pull the good parts out of CETA and apply them to the private sector. We will all benefit and so will those distressed areas.

Senator DIXON. I think it is a valuable point made in your presentation. I thank you for it.

For the record, our next witness is Mr. David A. R. Dullum, president of Frontenac Capital Corp. of Chicago.

STATEMENT OF DAVID A. R. DULLUM, PRESIDENT, FRONTENAC CAPITAL CORP., GENERAL PARTNER, FRONTENAC CO., CHICAGO, ILL.

Mr. **Dullum**. I will both read from and also edit my remarks which I submitted.

I am a comanaging partner of a venture capital investment firm located in Chicago. We have been in Chicago about 12 years. And in addition to that, I am the president of Frontenac Capital Corp., which is a small business investment company. I am also on the board of governors of the National Association of the SBIC, which is our trade association for small business investment companies.

Therefore, I am sorely concerned about the problems related to small businesses, both in the Chicago area and in the country. I am also very active in doing anything we possibly can to help spur on the growth of small businesses which clearly relates directly to generating capital for small businesses.

I feel that I am able to testify on the proposed enterprise zone legislation both from the perspective of an equity capital investor and companies or enterprises which may wish to take advantage of this zone concept as well as the benefit which may be arrived from enterprise zones.

I also wish to add that we focus our activity in Chicago, so this is the most immediate concern to us as well as the Midwest.

I, therefore, come at it from the perspective of the startup capital which has been mentioned here many times this morning, and which is needed and hopefully I will offer a few comments to give some feel as to what a startup capital investor may be interested in seeing as an incentive to cause him to invest in enterprise zone corporations.

Senator **Dixon**. I think that is very valuable. The existing legislation doesn't contemplate this, so your testimony is most welcome.

Mr. **Dullum**. I believe the enterprise zone proposal has merit. However, I wish to emphasize that it needs to be pragmatic and a true incentive for investment which can be quantified in terms of a rate of return on investment. In this regard, the main tenet has to be that if a company is going to either do business in or be attracted to an enterprise zone, then the fundamental business concept must be sound and not just provide an opportunity for someone to take advantage of tax concessions.

I reel it really has to be a meaningful business concept. As an example, and talking from the perspective now of an existing company in what I consider an enterprise zone, our firm owns a machine tool company employing approximately 300 people which is located in an area of Chicago that would more than likely qualify as an enterprise zone. As you know, the machine tool industry is currently economically depressed. However, it is certainly viable for the long term.

Given the continually aggravating labor problems and the age of the plant facilities, we continue to look at the viability of moving the operation to a more attractive business climate, and also where we could justify the new investments through economic incentives as well as greater return.

If, however, there were some opportunities to enhance the rate of return on the investment which is needed for capital equipment and revitalization of the manufacturing facilities, then the decision not to relocate would be more compelling.

I would like to offer some suggestions on incentives that may be used in this regard. They are not creative, they are not new, but certainly one is a tax credit on new investment. Now my deviation, however, is a tax credit in the range of 25 to 30 percent which is significantly higher than what has been suggested.

If you consider companies that have revenues in the range of $5 million to $20 million, I would suggest that this range is probably a representative sample and where they are earning profits after taxes of say 3 to 6 percent on revenues also is not unrealistic for the companies we are talking about. If each incremental new investment of $1 million would provide a tax credit to the company of, say, 30 percent, then the earned profits after taxes would increase by 1.5 percent to 6 percent of revenues before the expected manufacturing economics of efficiency improvements even take effect.

In other words, a 30-percent tax credit on the $1 million would bring to the bottom line based upon the range of the revenues somewhere to 1.5 and 6 percent of sales. This is a very significant return on investment.

I would also suggest this would be a major incentive to stay in a certain location. I wish to emphasize that while this tax credit may appear to be a large percentage, it is related to new investments which would not occur otherwise.

Second, a major reduction on capital gains taxes would be, I think, a major incentive. The best example I feel that could be used here, of course, is the recent rollback of the maximum capital gains tax which, as we all know, has strongly spurred on capital formation by venture capital firms throughout the country.

I feel that if you had a further reduction of capital gains taxes for companies which were in enterprise zones and therefore improving the risk reward profile, and this relates directly to Mr. Wishner's comment earlier regarding the at-risk dollars, I feel that would create an investor's willingness to stay in an enterprise zone location and invest further in an enterprise zone location.

I should say here, too, though, that I think that probably the tax credit which would be generated or the tax gain that would be generated should probably have some string attached which would casue it to be reinvested in enterprise zones. I think it would be unfair to the enterprise zone concept if one took a capital gain in an area, got a substantial reduction, and took those dollars and invested them somewhere else. I think there ought to be some strings based on the gains that would be generated which has been suggested and it relates to the SBIC legislation which I know you are familiar with and various other types of legislation in that regard.

In summary, my testimony is based on the need for the enterprise zone legislation to focus on ways to create new investment through a relistic and meaningful rate of return analysis and either toward capital formation and capital gains orientation as opposed to either interest rate reductions or other tax gimmicks which really do not go directly to the fact that a business [illegible]cept is what is really at stake.

[The prepared statement of Mr. Dullum follows:]

STATEMENT BY:
David A.R. Dullum,
President, Frontenac Capital Corporation
General Partner, Frontenac Company
208 South LaSalle Street, Suite 1900
Chicago, Illinois 60604
BEFORE SUBCOMMITTEE ON April 7, 1982
SENATE SMALL BUSINESS COMMITTEE

As a co-managing partner of a venture capital investment firm located in Chicago, I am able to testify on the proposed Enterprise Zone legislation from the perspective of both an investor in new enterprises which may wish to take advantage of the zone concept, as well as the benefit which may be derived by our existing portfolio companies located in the enterprise zones.

In concept I believe the enterprise zone proposal has merit, however, I wish to emphasize that it needs to be pragmatic and a true incentive for investment which can be quantified in terms of a rate of return on investment. In this regard, the main tenet has to be, that if a company is going to either do business in or be attracted to an enterprise zone, then the fundamental business concept must be sound and not just provide an opportunity for someone to take advantage of tax concessions.

For instance, our firm owns a machine tool company employing approximately 300 people which is located in an area of Chicago that would more than likely qualify as an enterprise zone. As you know, the machine tool industry is currently economically depressed, however, it is certainly viable for the long term. Given the continually aggravating labor problems and the age of the plant facilities we continue to look at the viability of moving the operation to a more attractive business climate where new investment could be justified. If, however, there were some opportunities to enhance the rate of return on the investment which is needed for capital equipment and revitalization of the manufacturing facilities, then the decision not to relocate would be more compelling. To this end, the following would be considered as major business incentives:

(1) A tax credit on new investment of between 25% - 30%.

> For example, if you consider companies with revenues in the range of $5 million to $20 million (this range is probably a representative sample of companies that would be in the enterprise zones) and which are earning profits after taxes of 3%-6% on revenues. If each incremental new investment of $1 million would provide a tax credit to the company of say 30%, then the earned profits after taxes would increase by 1.5% to 6% of revenues, before the expected manufacturing economies or efficiency improvements even take effect. This would be a major incentive to stay in an enterprise zone. I wish to emphasize that while this tax credit may appear to be a large percentage, it is related to new investments which would not occur otherwise.

(2) A major reduction on capital gains taxes.

The most representative example here is the increased equity capital investment activity which has occurred since the roll back of the maximum capital gains tax to 25%. I feel strongly that capital formation in general is improved by any tax savings on realized gains, however, a further reduction for investment in companies which are economically viable and in an enterprise zone would enhance the risk/reward profile and therefore an investor's willingness to invest in these locations.

In summary, my testimony is based on the need for the enterprise zone legislation to focus on ways to create new investment through a realistic and meaningful rate of return analysis.

Thank You.

Senator DIXON. I appreciate that, and I think what you have said here is that while you support the concept, you would suggest that the incentives aren't as sufficient an inducement for someone similarly situated as yourself. Is that substantially true?

Mr. DULLUM. Correct.

Senator DIXON. Well, I thank you very much and appreciate your contribution. May I say to you that anything additional that you may want to bring to the attention of the committee in the reasonably near future would be incorporated into the record.

The next panel is Mr. Mel Boldt, president of the Independent Business Association of Illinois; Mr. Joseph Williams, Minority Purchase Council of Chicago, and Mr, Charles Weber, the assistant to the treasurer of the State of Illinois, and Mr. Jose Pletz of the Illinois Federation of Hispanic Chambers of Commerce.

STATEMENT OF CHARLES WEBER, ASSISTANT TO THE TREASURER, STATE OF ILLINOIS

Mr. WEBER. On behalf of the State treasurer, Jerry Cosentino, I would like to express his thanks to you and the members of your committee for giving us the linked deposits. When we talk about linked deposits, we are talking about investments of idle public funds and also pension funds that are not needed for immediate disbursement in cooperating financial institutions which are pledged to making loans for specific community service purposes.

As you know, Senator, the program started in the State treasurer's office in 1969 and was expanded upon very well during your administration and during Treasurer Cosentino's administration. We have attempted to build on this foundation to bring the community service philosophy in more specific areas.

As the treasurer's statement addresses, and rather than reading it verbatim, I will just summarize some of the highlights of it.

He is proposing that linked deposits be an integral part of financing of enterprise zones. In other words, since many of the witnesses already have brought up the very considerable aspect of startup capital and how important it is for small businesses to have a sufficient supply of startup capital, what the linked deposit approach will do, particularly in the climate we have now with high interest rates literally choking off sources of investment capital that would be available to small business enterprises, is to enable Government entities to deposit funds say for a year or 6 months, whatever the duration of time deposit would be at a reduced rate of interest in exchange for the lender's cooperation or financial institution's cooperation that they will indeed pass on that reduced rate in the form of a loan for a specific community service purpose.

For example, if we wanted to apply it to an enterprise zone, for example, when a community in the city of Chicago is declared an enterprise zone, what we would like to see and what certainly would be a fine application of the linked deposits approach would be that the jurisdictions of the taxing bodies that have jurisdictions within that enterprise zone, their treasurers create a program of public funds that can be deposited or can be available for deposits in financial institutions that serve the enterprise zone.

And, of course, as we know, the financial institutions are bound by the Community Reinvestment Act and certainly the availability of these deposits would help them to fulfill their obligations under the Community Reinvestment Act.

So, If a pool of public fund deposits is created, and the treasurers of those taxing bodies would appoint a funding manager and the funding manager's responsibility would be to negotiate with the interested lending institution both within the enterprise zone and perhaps outside of it—for example, that would be in various neighborhoods that may be declared enterprise zones and/or perhaps financial institutions on LaSalle Street would be interested in participating.

The funding manager, with the cooperation of those treasurers, would set a rate and specify a deposit rate that would be charged to the banks for the deposits. In exchange for that, that funding manager would negotiate with the various lenders in deriving an acceptable rate of interest for the loans that would be made within the enterprise zone.

For example, let's take the issue of small business. Certainly, the startup of new business is a vital element of the success of enterprise zones. In the instance that a sufficient amount of capital were available through linked deposits, where if the taxing bodies made available the deposits in banks within those communities to small businessmen for an immediate source of short-term, startup capital—the duration of most startup loans is like mortgages. And we know that your interest in linked deposits is certainly a well-founded and sincere one.

This would not certainly be an expansive sort of capital. But nonetheless, by definition enterprise zones are very limited in their geographical area. Therefore, maybe $1 or $2 million for loans in the community could be a vital first step in creating that very much needed source of startup capital.

To summarize for a minute, in the treasurer's office, since 1966, the usage of linked deposits has been very successful. It was started in more of a general vein where every September 1, banks throughout the State are awarded 1-year time deposits of State funds. About 60 days prior to the allocation, bid forms are mailed to the banks for completion and immediate return. Information provided includes the amount requested, interest rate bid, amount of outstanding loans, and a breakdown by category of all outstanding loans. And they are evaluated both in terms of the rates that they bid, the amount that they want, the site of the bank and more or less the amount of outstanding loans that are made in prescribed areas that the treasurer at his discretion specifies.

So in this practice, we have been rewarding—State treasurers for the past 16 years have been rewarding banks for their past records of community service.

What Treasurer Cosentino has tried to do is to tie this more specifically to the various sectors of the economy. The treasurer in 1980 and 1981 made low-interest deposits for mortgages available through this deposit program, with the cooperation of the Home Builders of Illinois, were able to finance a program where deposits were made available in banks and savings and loans who in turn made low-interest home mortgages to buyers of newly constructed homes.

And the objective of this is not to be a cure-all for the real estate market, but it was helpful in enabling builders to stay in business and sell off their inventory and keep their tradesman at work and start new homes and keep the industry going.

And we have had letters in the office from many builders who said it was that difference, that one house and that they sold or those two or three houses that they were able to complete and sell off that kept those builders in business and kept their people at work.

In the farming community, Govenror Thompson had referred to earlier today, there is a program jointly sponsored whereby deposits were made available for low-interest loans to farmers. All of these in their way have been helpful in trying to relieve some of the hardships in various sectors of our community that have been hurt by high interest rates.

Getting back to enterprise zones, in summary, we believe that in a high-interest rate climate, the linked deposit approach is a sound starting block. And as capital becomes more available at reduced rates of interest, then this is rather a remedial approach, but nonetheless one that will be effective in starting an enterprise zone. It would certainly be useful in providing that badly needed infusion of startup capital, particularly when we all know that the interest rate is very critical because a small businessman or large businessman is not going to be willing to take a risk of investing in a depressed area at 16 or 17 percent prime.

So, therefore, the linked deposit approach will provide a source of lower interest capital to at least get some enterprise zones underway.

And, again, we would like to thank you very much for giving us the opportunity to present in summary form the views of Treasurer Cosentino.

Senator DIXON. I wish to express my warmest regards to State Treasurer Cosentino who is doing a fine job. We appreciate this statement and the entire statement will be produced in the record.

Mr. WEBER. The program is a laudable one because of your fine efforts in developing it. And it is nice to be able to go into an office where there is a sound foundation to build on.

And Treasurer Cosentino certainly is aware of the fine contribution that you made when you were State treasurer. And it was many of the things that you did that enabled us to expand on that foundation to do some good for the people of the State of Illinois.

Senator DIXON. You are kind. Thank you.

Now, we will have Mr. Boldt.

STATEMENT OF MELVIN W. BOLDT, PRESIDENT, BMI, INC., DES PLAINES, ILL.

Mr. BOLDT. My name is Mel Boldt. I am involved with Small Business United. I am president of BMI, Inc., a small metal stamping company in Des Plaines with 14 or 15 people. And I am pleased to be able to come and testify. And I would like to testify just as a small business person looking at this legislation.

It would not attract me or other small business people I know to move into an enterprise zone because it really fails to meet the one need, the most pressing need of the small businessman, the need for startup capital.

The tax incentives are good for people already in business. It is great for those who already have the need for shelter and great for some of the big companies. And these are needed in the zone. But it couldn't attract small businesses.

I think this failing could be in part met by having any of the suggestions that we have heard today like the investment interest being passed through to the lender. But I would like to suggest one other alternative for providing capital. And this was one of the recommendations of the White House Conference on Small Business, the small business participating debenture.

A small business debenture is a hybrid instrument. It would provide the small businessman with the capital he needs without giving up equity. But it would give the investor a better rate of return on his money going in. By breaking that return into two parts, the investor would receive interest, a nominal interest rate, and hopefully a smaller and lower interest rate on his investment. But he would also receive a share of the profits of the corporation for a stated period of time.

I think this would prove, to the investor, a sound investment in an enterprise zone firm. It would be a much better investment because of the capital gains treatment.

Senator **Dixon**. I think that that is a very valuable contribution. It is worthy of observation that such a bill is pending in the Senate now. I am not sure you are aware of that.

Mr. **Boldt**. I know there are two bills in the House.

Senator **Dixon**. But the chairman of this committee, Senator Weicker, has introduced a bill that would addresss that very question in the form that you have suggested. And I am hopeful that the testimony of practical people like yourself in the field who have experienced these problems will have a successful influence and show the importance of recognizing that an additional type of program is necessary to get this thing off the ground and really make it work.

Mr. **Boldt**. I am pleased to hear that. I know there are two bills in the House right now, but I think if the startup capital can be provided and small business can do its part to help, we will do our part.

Senator **Dixon**. I wonder if you would be kind enough to give your full report to the committee so that it will be in the record.

Mr. **Boldt**. Of course.

[The prepared statement of Mr. Boldt follows:]

Statement by:
Melvin W. Boldt

President, BMI, Inc.
825 Seegers Road
Des Plaines, Illinois 60016

Before the Subcommittee on Enterprize Zones
Senate Small Business Committee
April 7, 1982

My name is Mel Boldt. I am President of BMI, Inc. a small metal stamping company located in Des Plaines. I am Chairman of the Illinois Delegation to White House Conference, Chairman of the Public Affairs Committee of the Tool & Die Institute, and Vice President of the Independent Business Association of Illinois. I appreciate this oppurtunity to discuss with you the small business aspects of the Enterprize Zone legislation proposed by the Administration.

As the legislation currently stands it would attract few if any small business people because it fails to address their most critical need -access to low cost capital. This failing could be cured if the legislation incorporated the concept of Small Business Participating Debentures currently before Congress.

In starting up a new business an entrepreneur can be certain of only one thing - he(or she) will lose money for some period of time. Success or failure will be determined by his ability to reach a cash flow break-even before running out of start-up capital.

The tax incentives proposed will not facilitate easier access to start-up capital. Federal income tax consideration do not play a role in the most critical period of a fledgling firms existence. No tax is payable on the losses that must be absorbed during start-up.

Even after a new firm has reached a break-even the elimination of 75% of the corporate income tax provides little if any incentive to the entrepreneur. During the growth stage little if any taxes are paid because all the money available is used to finance expansion. With few exceptions an entrepreneur starting a new business will not face substantial tax bills for eight to ten years after opening the door.

The continued availability of Industrial Revenue Bonds within the Enterprize Zone will not provide start-up capital. Because of the cost of your lawyer, bond counsel, and counsel for the city, the break-even on Industrial Revenue Bonds versus conventional financing is about $750,000. Not many small business people have the credit-ability to float a three-quarter of a million dollar bond issue.

The tax incentive in the proposed legislation will be attractive to those companies that already have the massive amounts of capital needed to enter or expand in the lucrative markets dominated by big business. They will be attractive to companies that already have substantial income subject to taxation. They will not be attractive to most small business people or those that hope to become small business people.

In order to attract small business to the Enterprize Zone start-up capital must be made available. In keeping with the philosophy of less government involvement in the Zone the source of the capital should be private not public.

Small business people could attract the private capital they need to locate in enterprize zones if the legislation would implement one of the top recommendations of the White House Conference on Small Business - the Small Business Participating Debenture.

The SBPD would offer an Enterprize Zone small business capital without giving up equity. It would give the investor a stated rate of return plus a negotiated share of the profits for a limited time at favorable tax rates with a limited downside potential.

The SBPD would be a hybred instrument issued by a qualifying small business which first is a general obligation of the company; second bears a stated rate of interest; third has a fixed maturity date; fourth grants no voting or conversion rights in the company; and fifth provides for a payment of a share of the company's total earnings to the investor. The specific terms of the SBPD, such as the interest rate, maturity date and share of earnings would be negotiated between the business and the investor.

The stated interest received would be taxable to the investor as ordinary income. However, amounts paid as a share of the company's earnings would be taxable to the investor at the long-term capital gains rate. An individual investor would generally treat losses on SBPD's as an ordinary loss thereby limiting his downside risk.

Including the SBPD in the Enterprize Zone legislation would provide the desperately needed low cost start-up capital for the entrepreneur. Investors would discover that a new or expanding Enterprize Zone business is one of the best places for his money rather than one of the worst. He would have the benefit of realizing the appreciation of his investment at capital gains rates without having to dispose of it. The potential gain on a successful investment would off-set the risk.

There are currently two pieces of legislation in the Congress which specifically address creation of a Small Business Participating Debenture - HR4015 introduced by Congressman Dennis Eckart (D-Ohio) and HR5078 introduced by Congressman Dan Marriott (R-Utah). These measures have been referred to the House Ways & Means Committee.

It is imperative that the Enterprize Zone legislation contain a provision for the Small Business Participating Debenture. It is the most economical way of attracting the start-up capital needed if small business is to do its part in rebuilding America's inner-cities.

APPENDIX TO STATEMENT OF MELVIN W. BOLDT

SMALL BUSINESS PARTICIPATING DEBENTURES

THE PROBLEM

America was made great because of the foresight and courage of two very different segments of our economy. One was represented by the hard-working, innovative entrepreneur and the other by his partner, the wealthy individual or financial institution that supplied funds for new and expanding enterprises. Today, we have plenty of small businessmen who can fill the first role as well as ever, but, unfortunately, there are almost no financial risk-takers around to support their ventures. These are a few of the reasons:

1. The most viable source for funds in the past have been commercial banks; but with the gradual disappearance of the small, locally owned and managed bank, these funds have become less available. Today's major banks substantially neglect the small business, while committing most of their funds to their larger customers and other safe high-yield investments, or even to acquire smaller banks.
2. More and more of the nation's wealth is being accumulated by insurance companies, pension benefit trusts and other institutions. Regulations and traditional investment habits prevent these funds from being directed toward risk situations; in fact, even low risk situations, if they are small businesses, have a lack of acceptance in the institutional investment market place.
3. The motivation for an individual investor to direct his funds towards small business has virtually disappeared. If he wants to become a "lender", he would have to charge an incredibly high interest rate to warrant the additional risk he would be taking

compared to money market funds or similar investments. Whatever interest rate he earns, however, will be subject to ordinary tax rates and, if the investment is bad, he will incur a capital loss, having relatively little tax benefit to offset the economic loss. On the other hand, should he turn to a purchase of equity, there is no way to realize either return of or return on the investment without either selling his holdings or being penalized by the prohibitive double tax on dividends. Furthermore, even if he is willing to sell, his investment may have little or no marketability.

4. The limited number of venture capitalists, those who have risk capital to commit to energing businesses, enjoy a "buyer's" market. They are able to call the shots to whatever extent they wish and, in fact, put many entrepreneurs in a subordinate position within their own ventures. In some instances, they attempt to negotiate so much of the equity and control for themselves that many owners would rather not stay in business than have their companies run by outsiders.

THE SOLUTION

The delegates to the 1980 White House Conference on Small Business named as their 9th priority recommendation the creation of tax incentives in the form of a Small Business Participating Debenture (SBPD) to provide a new source of capital for small businesses. The SBPD appears to solve most, if not all, the problems enumerated above.

An SBPD offers to the small business capital without giving up equity or having to tap existing sources of debt financing which, if available, are often unaffordable. For the investor, an SBPD offers a stated rate of return, plus a negotiated share of the profits for a limited period of time.

The SBPD would be a hybird instrument issued by a qualifying small business which first, is a general obligation of the company; second, bears a stated rate of interest; third, has a fixed maturity date; fourth, grants no voting or conversion rights in the company, and fifth, provides for a payment of a share of the company's total earnings to the investor. The specific terms of the SBPD, such as the interest rate, maturity date and share of earnings, would be determined by the market for the debenture, and negotiated at arms length between the business and the investor.

The stated interest received would be taxable to the investor as ordinary income. However, amounts paid as a distribution of a share of the company's earnings would be taxable to the investor at the preferential long-term capital gains rate. An individual investor would generally treat losses on SBPDs as ordinary losses.

A SBPD could only be issued by a domestic trade or business, whether or not incorporated, which has a net equity of less than ten million. Only companies which do not have securities outstanding which are subject to SEC regulation would be eligible to use SBPDs. Additionally, no company may have issued and outstanding, at one time, SBPDs with a face value in excess of one million.

SBPDs create an affordable alternative for small businesses to raise needed capital without the loss of equity.

Small business believes the approach would attract new investors because it will offer an opportunity to share in the fruits of a potentially flourishing business, potentially unlimited profits as opposed to a stated interest rate, tax treatment of such income at the capital gains rate and limited downside potential (a loss minimized by a tax write-off).

An additional advantage is the probability that there would be no actual cost to the Treasury. The more likely result would be that such investment would begin a cycle of activity that would generate capital investment, new jobs and more Federal revenues.

A bill to establish the concept of a SBPD in the tax code has been introduced by Congressman Dennis Eckart of Ohio and has been referred to the Committee on Ways and Means. The bill, H.R. 4015.

Consequently, the investor will find that new or expanding businesses will become one of the best places for his money, rather than one of the worst. He will have the benefit of realizing the appreciation of his investment at capital gains rates without having to dispose of it. The potential gain on a successful investment would certainly warrant the risk. In summary, he will have an investment with the security and yield potential of a note, with the upside potential and tax attributes of stock.

For the entrepreneur, SBPDs will make available desperately needed funds for product development, market development or physical expansion. The typical small businessman will not mind generously sharing his profits, as long as he knows that he is in control of his company and that there is a predetermined method for him to pay off his partner when his business can obtain conventional financing.

QUESTIONS AND ANSWERS

Q: Won't the cost of this apparent bonanza be prohibitive?

A: Absolutely not! Although some of the funds will come from ordinary income-type investments, much of the capital will be diverted from "tax shelters" and tax free bonds. More importantly, though, logic dictates that there will be virtually immediate revenue enhancement. No businessman is going to give up potential profits unless he plans to use the capital for immediate deployment into personnel or equipment.

Q: Will we be creating more Government involvement and red tape?

A: There is no contemplation of any governmental involvement other than the proscribing of tax rules to avoid abuses. If the company desires to split the debentures into many small units, it would be subject only to those registration rules now in effect. This will be a free enterprise/open market activity.

Q: Like so many other "small" business proposals, will the big companies get the real benefit?

A: No. Besides the fact that mature companies don't need this vehicle, all proposed legislation limits the amount of eligible investment in any one company.

Q: Who would be the investors?

A: They could be anyone who wants to invest in the future of America through small business, provided the tax attributies of the investment are compatible. For example, individuals who have confidence in a particular entrepreneur, would no longer be reluctant to risk their capital in this manner. Banks and insurance companies would now have motivation to allocate some of their monies into this exciting segment of the economy. Finally, even the small investor can participate through investment partnerships which would undoubtedly spring up. These partnerships, probably sponsored by investment bankers, might sell the units for as low as $5,000. Each partnership would then make many investments, thereby reducing investor risk through diversification. Naturally, the tax attributes of the investments would pass through to the individual partners.

CURRENT STATUS

There are currently two pieces of legislation in the Congress which specifically address creation of a Small Business Participating Debenture: HR 4015, introduced by Congressman Dennis Eckart (D-Ohio), and HR 5078, introduced by Congressman Dan Marriott (R-Utah).

It is imperative that the Concept of Small Business Participating Debentures receive immediate Congressional approval. The benefits of the SBPD are manifold:

For The Entrepreneur

- easier access to much-needed financing
- deductible payouts
- redeemable investments
- no sacrifice of business ownership and control

For The Investor

- High potential yield, limited downside
- Capital gains treatment
- Investment payback
- Ordinary write-off, in case of loss

For The Economy

- Minimal revenue impact
- Immediate deployment of funds for private investment in equipment and new jobs
- No extra paperwork
- Revival of small business growth

Senator DIXON. Mr. Joseph A. Williams, president of the Chicago Regional Purchasing Council, and president, Arrow Services.

STATEMENT OF JOSEPH A. WILLIAMS, PRESIDENT, CHICAGO REGIONAL PURCHASING COUNCIL (CRPC), PRESIDENT, ARROW SERVICES, INC., CHICAGO, ILL.

Mr. **WILLIAMS**. Of course I am always glad to see you and the staff. I am always impressed by all the things you are doing for Illinois.

One of the things that I am concerned about as a small businessman is I am not sure that enough business people have been asked enough about what this legislation is about, and I think that might be a shortcoming from day one as to how we are going to resolve the problem.

Senator DIXON. If I may interrupt, your point is entirely valid. We hope that hearings such as this one all over the country in a variety of other large and small towns will acquire the kind of input that will help us to formulate a final bill that Joe Williams and Mel Boldt and others will say is a worthwhile effort.

Mr. **WILLIAMS**. You have my comments for the record. All I would like to do is to extract a few key points and generally share with you some of my observations even about the hearing as I have heard it develop this morning.

First of all, I am the past chairman of the Minority Business Subcouncil-Chicago Regional Purchasing Council and now am president of that group. Even though I am a minority business owner, I have been given the privilege of running basically a corporate organization in the private sector that has as its mandate creating economic opportunites for minorities. In addition, with Mel, I am a member of the Independent Businessmen's Association of Illinois and on the executive committee of the Small Business Council of Chicago Association of Commerce and Industry. I am newly elected as a principal of Chicago United, an organization that is very much concerned about the maintenance and improvement of Chicago. And finally, I am ending, as of tomorrow, my tour of duty with Governor Thompson's task force on enterprise zones which is designed to create the State legislation to merge with the Federal legislation.

My very first observation is that the legislation, though nice, and well intentioned, does not really hit at the heart of the problem. I think that every study that we have recently looked at, and this is coming from the White House Conference on Small Business, a recent study that was done by a magazine of small businesses nationwide, a recent study which was done for Chicago United on Minority Business concerns in 1981—every one of those studies came up with one basic answer. That is, "Small businesses need capital."

A really small business doesn't really need too much more than capital. It is interesting that as I have observed this process over the years, businesses survive because they have good management and they have access to capital.

Taken in this kind of climate, any business that can survive, I'm here to tell you clearly has some great management.

The question becomes, even with that management, where can they get the funds?

As we look at what small businesses need—we are interested in a number of things. Clearly, access to capital is No. 1. All small businesses, and we are not always so blessed, would like to be part of a growth industry. We would like to have highly motivated employees. We would like to be in crime-free areas and we would like to have great surroundings and great infrastructures.

I haven't been able to detect in any urban enterprise zones that any of these things that small businesses need are really going to be available. So we start from a base of the government saying we want to create tax incentives, we want to do all we can. But from a business perspective, most of that means little to us.

The most important element is "access to capital."

I am very proud and very pleased to see what has happened with minority businesses and see how they have evolved and developed over the years and how some of us have gone on and continued to try to create the jobs and do what we have to do in our own communities. And I think that effort at doing something is something that has made the difference in creating a willingness on the part of small businesses to get involved in their communities as long as there is an opportunity for them to survive and grow and make a profit.

The point I am trying to make here with access to capital is that small businesses need it to go out and get the job done. An entrepreneur getting his job done is automatically going to create jobs. This is a known fact in every study that has ever been published which substantiates that if the entrepreneur fulfills his mission, what he is automatically going to do is create jobs.

The second thing he is going to do is stabilize the community because he is going to repair his property. He is going to keep his property in shape. He is going to upgrade the property.

So, it is a basic kind of opportunity that continues to be missed in all of the commentary that I hear. If we don't have a real way of developing this access to capital, he is not going to be able to do this.

I was very pleased this morning to hear Mr. Wishner, president of Walter Heller, making his comments, because as I said earlier, the thing that concerns me the most is that the private sector probably has the best capability of insuring those areas, whether they are enterprise zones or not, can in fact continue to be viable entities. And unless we are creating the type of ingredients that make financial people want to get involved, we are not going to be on target with this one.

I think that unless we are willing to deal with that, probably a lot of this enterprise zone idea, and I agree with Mel on this, that as far as the small business community is concerned, I just don't see that you are going to find any small businessman who once he sees this legislation in final form who will be willing to go out and take that chance.

If he is viable, if he has got capital, if he is in Winnetka, there is no way he is going to come back to Chicago. He is not going to make that decision.

If he is not viable and if there is no capital, he is still not going to be in a position to go. I don't think that you are going to see small business take up this mantle, take up this charge, be the leader in creating jobs unless you do something that really makes small business want to do that.

I haven't seen that. I don't know how the final Federal legislation will come out, but it is clear to me that if there are no financial incentives for private enterprise to do the capital formation necessary to be there, small business will have a very limited role in the ultimate output or whatever the enterprise systems are all about.

[The prepared statement of Mr. Williams follows:]

Statement by
Joseph A. Williams
President, Chicago Regional Purchasing Council (CRPC)
President, Arrow Services, Inc.
5659 South LaSalle Street
Post Office Box 21002
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April 7, 1982

Before Subcommittee on: INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

Senate Small Business Committee

Senator Dixon, members of the United States Senate Small Business Committee here present, interested citizenry, and my fellow business persons, I am speaking today as a Small Business person, who is concerned about the future of Small Business.

By the way of background, I have headed a group of Minority business persons, was a delegate to the White House Conference on Small Business, am a member of the Independent Businessmen's Association of Illinois, on the Executive Committee of the Small Business Council of Chicago Association of Commerce and Industry, a Principle of Chicago United--which is vitally concerned about the maintenance and improvement of Chicago--and finally have been a member of Governor Thompson's Task Force on Enterprise Zones.

Because I am an eternal optimist, I cannot close the door on any proposal that has at least a shread of possibility of providing some stimulis to help Small Businesses "go" and "grow". However, the "shread" or "thread" that I see in the proposed legislation of the Reagan Administration is thin indeed and does not attack with optimism or enthusiasm the needs of Small Business and therefore cannot be thought of as an incentive for Small Businesses to charge forward and grab up in their quest for success and growth.

The average Small Business today has at its head an opportunist; a person who sees a way to make it big by doing something for himself rather than have someone determine his success by doing something for him. He generally creates jobs and helps to develop areas because of this desire to "make it". It is however not his "primary" objective.

The Small Business person, Minority or otherwise, in decending order of importance needs:

-Access to capital
-To be a part of a growth industry
-To employ highly motivated employees
-To be in a crime free areas
-Great surroundings including excellent infrastructure & services

In every respect, the wants and needs of Small Business are not considered when one talks about revitalizing depressed, urban decaying areas that have high unemployment, crime, deteriorating neighborhoods and little industry at present.

I do not believe that the legislation as presently constructed will cause a stampede of Small Business owners attempting to become zone residents. The tax incentives as listed, are empty measures to a new small business because their need for tax credits are in the distant future. Existing businesses will gain some advantages if they expand, however, the cost of an unskilled, unmanagable labor force far outweighs the tax advantage gained.

The administration would like to see Small Businesses commit and if we did, it would truly make a difference in our cities today. Why? Because Small Businesses make up:

-99% of all businesses.

-We contributed 75.5% of all the new jobs between 1967 - 1977

On the other hand, Small Business generally has had problems in the past.

-Our share of the GNP generated in 1967 was 52%.
In 1977, our share of the GNP had been reduced to 48%.

-Business failures among Small Businesses are rising and as a result of this, we have lost some jobs over the past years. Recent statistics released by House Small Business Committee Chairman Mitchell show that business bankruptcy filings in 1981 were the highest since World War II and business failures were the highest in 20 years, with more than 47,000 filing for bankruptcy in 1981 and over 17,000 firms closing their doors. Further according to Dun & Bradstreet there was a net reduction in businesses with one to four employees between 1977 and 1979

To put it bluntly; Small Business is hurting. We are struggling to survive! period! Under what rationale can anyone believe we can truly reach out and pull up the underemployed, the unemployed and the decaying communities of our Urban areas. We cannot and in my belief we will not, unless there is a change in the present economic climate. What is the change we need? Small Business needs two (2) things.

1. Access to capital
2. Relief from high interest rates

These two simple antedotes could be the shot in the arm to help Small Business. Small Business has the entrepreneurs who are opportunists. With capital and an opportunity to get cheap plant & equipment, Small Business will move. With available affordable labor Small Business will move. It is therefore my opinion that "access to capital" not tax incentives is the key to successful Urban Enterprise Zones.

Lend us the capital at attractive rates and we will rebuild the cities. Without capital we have no incentives and our participation will be minimal.

Senator **Dixon**. I thank you, Joe. You are an old friend and a valued friend. What you have said here is an excellent contribution.

At the expense of being the devil's advocate, you present two things that are important here. First, you think in its present form, the bill just won't get the job done, which is generally to turn around the inner cities of America and give job opportunities to small business people and new trade opportunities to working people who otherwise would be disadvantaged.

The other problem is that you have to have this capital incentive to get it started. That is what you are saying and that is what Mel is saying. It is what Maynard is saying.

On the other hand, we can't have another program like the direct small business loan program. We had a hearing in Washington, and one witness after another said their responsibility was to get the money on the street. That didn't work and it won't work. And so we have to find some kind of a decent approach that will make the capital incentive feature part of this legislation available while avoiding the waste, the mismanagement, and other problems which have occurred with these programs in the past. It is a very hard balancing act.

Mr. **Williams**. I would like to respond. I don't think that the Government can do it, in the first place. I think that the bureaucracy is just too cumbersome. I heard somebody say that the enterprise zone is a pilot project and it is going to take 2 or 3 years of study.

I have recent statistics that in 1981, business failures were the highest in 10 years and more than 47,000 filings for bankruptcy since 1981 have occurred and 17,000 firms have closed their doors.

If we take that statistic and some of this information, we are in dire straits rights now.

So if we construe that this pilot project is in fact a pilot programs, I have nothing wrong with that. What I am saying to you is while people in Government are evaluating, how long can we make it? A lot of small businesses are going to go out of business. And if they are out of business, as Governor Thompson said, what difference would it make how great the program is.

I think that the private sector can do it. The people that I talk to, whether it be at Chicago United or major banks in the city of Chicago, they say give us a reason, give us an economic reason to get involved and we will get involved. But don't give us a do-good program. We can't wave our social hat in 1982 when some of are worried about whether or not we are going to be around. Give us an economic reason to be involved, and we will be involved.

Senator **Dixon**. I think Mr. Williams and Mr. Wishner and Mr. Boldt are really saying the same thing from different perspectives, are they not? And that is the value of this hearing.

If we can do something through the private sector that gives it initiatives to undertake this program from the economic standpoint, that is good. It is too much to do for a bunch of do-gooders realistically If we can do that in some way and not have government doing it, because that has failed every time we have tried it, then we have something meaningful. That is what we have to seek. I thank you.

Mr. Boldt. You are saying if we could get this program working by getting the government off the backs of small business people in the enterprise zones, we can show that it works, this may well be successful throughout the country and reduce the role that Government is playing now.

Senator Dixon. Thank you, Mel, and Joe. We appreciate your putting your statements in the record where they will be available for Senator Weicker and Senator Nunn and all the members of the committee.

The next panel consists of Mr. James A. Fitch, president of South Chicago Savings Bank; Mr. John Mullins of the DeKalb Economic Counci; and Mr. James Patterson of CANDO. We are delighted to see you gentlemen.

STATEMENT OF JAMES A. FITCH, PRESIDENT, SOUTH CHICAGO SAVINGS BANK, CHICAGO, ILL.

Mr. Fitch. I am the president of the South Chicago Savings Bank. It is nice to be here and present a point of view concerning an enterprise zone.

South Chicago Savings Bank is a community bank on the southeast side of Chicago. I am also president of the Illinois Bankers' Association which is a trade association of community banks representing only warmhearted bankers. And I am also president of the South Chicago Economic Development Commission which represents the general southeast area of Chicago, comprising mostly the basic steel industry. I am wearing all three of those hats today, Senator, and all of these organizations strongly support the enterprise zone concept.

My testimony will briefly cover three areas of concern: The first is enhancing the role of local lending institutions in enterprise zones. The second is the relationship of small and large businesses within a zone. And the third is the size of enterprise zones.

The cost of borrowing fixed and working capital may be the single most critical determinant of success of small business in enterprise zones. The propsoed incentives alone will not sufficiently encourage entrepreneurs to establish new or expand existing businesses in areas already experiencing hardship because insufficient access to needed capital.

The problem of available capital has not been fully addressed in the current Federal bill. We are aware that industrial development revenue bonds would continue to be available in enterprise zones. However, each bond issue typically benefits only one user and in reality only a large business. Small businesses do not have this below-market-rate source of capital available to them. Pooling of users, small, medium, and large single IDRB issues with the zone as a common bond should not only be permitted but encouraged. This would require the rescission of IRS rule No. 81-216 which prohibits pooling.

Senator Dixon. May I interrupt to say that you should know that I have joined Senator Weicker in introducing a bill on 81-216 that would reverse the IRS position on that.

Mr. Fitch. Should I take that out or can we leave it in?

Senator DIXON. You can leave it in there, Jim. I need your support.

Mr. FITCH. Participating firms could share the up front cost of bond issues otherwise too costly for individual borrowers and thus make capital available to small businesses in enterprise zones. Local banks could play a key role as packagers of these joint efforts. With some relaxation of existing statutes prohibiting revenue bond underwriting—now being considered by the Congress—local banks could serve in this way as well.

IDRB's are not the sole solution to the problem of available capital, however; alternative sources for capital must be developed.

And certainly, Mr. Wishner's creative comments this morning should be very carefully studied by your committee.

Deposits of Federal funds in local lending institutions may be one way to develop resources for capital. A similar idea is now used by HUD with Federal community development block grant funds, regulations allow the early distribution of allocations—known as lump sum drawdowns. These funds are deposited with local lending institutions which have agreed to specific requirements. This policy should be expanded to other Federal funds. Deposits could be directed toward banks which are located in enterprise zones and which are participating in zone activities.

A secondary market for loans made to eligible enterprise zone businesses should be created to provide another source of capital similar to the SBA 503 program debentures.

I also suggest the establishment of an Enterprise Zone Authority, EZA, to act as an insuring agency—similar to FHA. The FHA concept has a proven track record enabling families to own their own homes when otherwise locked out of the market. EZA would ensure credit availability to deserving entrepreneurs otherwise locked out by low real estate values and other adverse conditions that led to the development of the depressed area in the first place.

Senator DIXON. That is a very interesting concept.

Mr. FITCH. Well, we have seen FHA work well, Senator.

Senator DIXON. That is a suggestion brought here for the first time, and I appreciate that.

Mr. FITCH. My second concern is to emphasize that a strong relationship exists between small and large businesses and that enterprise zones should exclude neither.

Enterprise zones are to be environments of opportunity where jobs are retained and created.

It is imperative that restraints not be imposed that curtail development and limit the potential of the zone. A community of mutual encouragement is necessary to redevelop depressed areas. Equally important to the need for new jobs is the need to insure the retention of existing jobs regardless of the size of the employer.

A combination of large and small business will generate a zone of opportunity. Large businesses attract smaller businesses which provide supportive and ancillary functions.

Studies show that most jobs are created by very small businesses mostly in retail and service organizations. This type of activity will flourish where there are customers with funds to spend—funds obtained from employment, regardless of the size of the employer.

Finally, I am concerned about the proposed limited size of enterprise zones. Though size is not specified in the Federal bill, administration position papers stress that zones will be less than 5 square miles. It is difficult to find an area within a major city which is that small and has the elements necessary to make an enterprise zone succeed: The combination of vacant land, residential development and small and large business. With such a limited scope this noble experiment in redevelopment will only provide inconclusive results.

The size of an enterprise zone should be of no moment if the purpose of an enterprise zone is to be fulfilled—the restoration of depressed urban areas into viable, income-producing territories of opportunity.

Thank you very much for having me.

Senator DIXON. I really appreciate very much several novel things you have suggested here. And I might also add that your ideas on the question of the size of the zone, which I had indicated earlier to the news media before I came in here for the meeting, that—that was one of the important things as well. We haven't discussed the question of the size of the zones until this very moment. They are much too small in the administration program. That alone could be a major negative in the enterprise zone legislation.

So, I thank you very much for coming and for your valuable contribution.

STATEMENT OF JAMES PATTERSON, EXECUTIVE DIRECTOR, GREATER WEST SIDE DEVELOPMENT CORP., CHICAGO, ILL.

Mr. PATTERSON. Mr. Chairman, we wish to thank you and all members of the committee for inviting us to appear in behalf of urban economic development. We have brought with us certain studies and documents relating to our work. We would like to present these materials as a supportive exhibit.

Mr. Chairman, I am James Patterson, the executive director of the Greater West Side Development Corp. in Chicago. We are a not-for-profit, neighborhood development corporation serving Chicago's low-income, minority west side. It has also been my pleasure to serve as a subcommittee chairman on enterprise zones for the Chicago Association of Neighborhood Organizations with economic development programs. In addition, I am a director of an out-of-State economic consultancy firm, named Enterprise Development Inc., which has done considerable research on small business venture capital.

It is the formal position of the Chicago Association of Neighborhood Development Organizations [CANDO] that we endorse the Kemp-Garcia Enterprise Zone Act (H.R. 3824) with some modest revisions.

The Chicago Association of Neighborhood Development Organizations feels that the currect Kemp-Garcia bill, the Urban Jobs and Enterprise Zone Act of 1981, is much better legislation than the original bill proposed a year earlier. We feel the current bill has a sensible and prudent balance of incentives to encourage business investment. In particular, we feel it is a wise course of action that no special health, safety, or pollution control regulation modifications have been proposed for the designated zones.

In addition, we agree with a whole string of witnesses that enterprise zones are not a substitute for current programs. We must recognize that enterprise zones can't simply substitute for existing direct assistance programs. But we should also recognize that they bring new tools to help us meet our old challenge of restoring inner-city jobs and economic vitality.

We feel that one of the strongest features of the current Kemp-Garcia bill is the simple and concise purpose of the legislation. It would be a mistake to take a Christmas-tree-type approach with the legislation and hang unlimited new economic development ornaments on the bill. However, we feel that some modest clarifications and amendments should be included in the legislation.

Zone size criteria: A sense of the Congress resolution should be written into the legislation stating that zone applications to the Federal Government from larger cities should be permitted to encompass proportionally larger geographic areas. Truly large cities like New York, Chicago, and Los Angeles should, afterall, be able to encompass larger areas of their cities within enterprise zones, since those cities possess greater numbers of poor people and larger areas of urban blight. Chicago has roughly 10 times the population of the city of St. Louis.

Despite Federal injunctions that no city could have more than one Model Cities neighborhood, New York selected, and after much complaint, HUD approved designations of the South Bronx, Harlem, and Central Brooklyn. All three areas were clearly eligible but it was the political difficulty of choosing among them that led the city, and then the Federal Government, to approve all three.

Flexible benefit schedule: Since it is likely that some firms that might otherwise be attracted to the inner-city business site will find it impossible to comply with the 40 percent CETA hiring requirements in the Kemp-Garcia bill because of the higher labor skill levels of their particular business, we would recommend that the legislation adopt a flexible benefit schedule based upon flexible CETA hirings. For instance, a firm that would hire 15 percent CETA would gain 30 percent of the tax reduction advantages; 30 percent CETA would gain 60 percent of the advantages, and 40 percent CETA will gain 100 percent.

Inner-city SBIC's: If we truly desire substantial inner-city revitalization and the creation of many new jobs, the most important urban economic revitalization task is the attraction to low-income communities of new businesses—not only employment producing new manufacturing firms, but new commercial businessses to occupy vacant storefronts and competitive firms that will bring the proper retail mix to the community's shopping areas. Amongst the many incentives that might be offered, a program of aggressive equity investments in small businesses affords probably the greatest potential for attracting new businesses to such areas. Most public markets and institutional capital sources have reduced equity placements in recent years for even the most high potential businesses; consequently, most small manufacturing and retail firms have virtually no access to equity funds other than friends and relatives.

Tax breaks, reduced land costs, lower interest loans, and other services may be significant incentives to induce businesses to locate in inner-city business sites. Services and opportunities offered by a great many communities are usually attractive, but not essential for businesses. In contrast, small business equity capital is almost impossible for companies to obtain. Acquiring the proper equity funds is very often the critical difference as to whether a business can get into business, stay in business, or expand in a significant way.

Creative small business venture capital investment programs for inner-city, usually minority, areas that can offer reasonably priced (cost to the business) equity dollars while potentially safeguarding and enhancing the return of private investors offer a great overall potential. Innovative uses of public sector dollars and government investment guarantees provide a high potential way to proceed, including but not limited to the use of community development block grant [CDBG] funds.

According to Congressman Kemp in the National Journal, "We've never argued that taxes are the sole problem facing businesses in the inner city. We know they have venture capital problems."

Although small business investment programs are best organized at the State and local level, usually by augmenting existing Federal SBA incentives, we offer two proposals for new venture capital activities that are truly Federal in their jurisdiction.

First, we propose that section (301)(d) SBIC's be permitted to invest in nonminority businesses in designated urban enterprise zones. Such legislation would enable the so-called MESBIC's to provide venture capital for many marginal but risk-worthy business ventures. The legislation could either require the formation of new MESBIC's to specifically service enterprise zones or else permit the existing MESBIC industry, currently in place, to make such job-generating, inner-city investments. We support the latter.

Second, we would propose that legislation be enacted that declares community development block grant [CDBG] funds to be private capital for purposes of the Small Business Investment Act, if invested in "enterprise zones eligible" businesses. Such legislation would provide a new source of venture capital for SBIC's and MESBIC's and would cost no additional Government funds, but would instead more intelligently redirect existing resources. The extreme competition for such funds amongst alternative urban needs will necessitate their careful utilization.

Zone management. We also feel that the legislation could be strengthened by more directly encouraging the involvement in zone management of one or more neighborhood organizations serving that local community. The competitive application to the Federal Government for zone designation might receive a much greater rating if substantial community involvement is part of the package of services for the zone.

The essence of the Kemp-Garcia is that it "greenlines" some of our poorest communities by increasing incentives for working, producing, and risk-taking within these areas. We believe this approach to economic development should be given serious consideration and support.

We believe that an improved version of the Kemp-Garcia bill, in conjunction with other well-financed and well-thought-out urban programs, can make our cities good places for business and, more important, better places for us to live.

Mr. Chairman, we also appreciate this opportunity to present our views on the vital necessity of creating a new capital base in underdeveloped regions.

We believe the stimulating of private enterprise enlarging a region's own private capital base and creating an attitude for growth and ownership among the people are the next steps which must be taken if the inner-city areas are to contribute their fair share to the national economy. Only then will there be a fuller return on the public investments authorized and appropriated by Congress.

It is our experience through Enterprise Development Inc. that the lack of entrepreneurial experience and equity capital must be remedied in order to produce jobs, profits, and an enlarged tax base in the inner city and other underdeveloped regions. While these factors are universal to business, they are acute in our low-income neighborhoods. These problems can, we believe, be addressed through properly organized small business investment companies [SBIC's].

A depressed area does, by definition, suffer from a lack of risk or equity capital. Conventional financing is available, but an economically underdeveloped area suffers not so much from a lack of collateralized funds as from a readiness to perceive new types of lending opportunities and then the ability to come forward with the working capital. Tied to this deficiency of an active capital base is the lack of equity ownership, and thus lack of involvement on the part of the great mass of the people of an underdeveloped areas. In short, experience with the rewards of modern capitalism is practically nonexistent in the inner city. Until this is changed, no amount of public works and public welfare, however well planned, will fully energize the people.

Initial investments in community-based small business investment companies could come not only from established financial and industrial interests in a region, but also through a mutual fund technique, private individuals could invest as little as $10 per month in order to have a stake in building their communities, providing jobs for themselves, and equity for their children.

One key to the success of the program is the providing of expert SBIC management counseling on a continuing basis. Such guidance can be given through an organized nonprofit management service furnishing promotional, legal, management, financial, and marketing services.

We propose that a set of programs or incentives comparable to the U.S. Government's neighborhood business revitalization [NRB] program, which has induced considerable local development through SBA 502 and 503 financings, should be extended to the formation of community-based SBIC's.

In conclusion, we believe that the tensions in our large cities are caused by the lack of meaningful participation in the vital economic growth of our country. The economic base from which wealth was produced once consisted of the simple ownership of land and the ability of the persistent farmer, as stubbornly purposeful as his mules in making it pay. Today the capital base, equity ownership, the wealth production resources come in different forms and are, for the most part, in the hands of a few others. Inner-city people, as other Americans from all walks of life, are beginning to understand this.

It is only through building new enterprises in which we can work and, if we choose, share ownership by buying equity that real participation can be achieved. This is what we are trying to do. We believe it will work.

Thank you very much.

[The prepared statement of Mr. Patterson follows:]

Chicago Capital Base

ENTERPRISE DEVELOPMENT INCORPORATED

From: James Patterson

Date: January 12, 1982

Re: INNER-CITY SBICs

If we truly want substantial inner-city revitalization and the creation of many new jobs, the most important urban economic revitalization task is the attraction to low-income communities of new businesses -- not only employment producing new manufacturing firms, but new commercial businesses to occupy vacant storefronts and competitive firms that will bring the proper retail mix to the community's shopping areas. Amongst the many incentives that might be offered, a program of aggressive equity investments in small businesses affords probably the greatest potential for attracting new businesses to such areas. Most public markets and institutional capital sources have reduced equity placements in recent years for even the most high potential businesses; consequently, most small manufacturing and retail firms have virtually no access to equity funds other than friends and relatives.

Tax breaks, reduced land costs, lower interest loans, and other services may be significant incentives to induce businesses to locate in inner-city business sites. Services and opportunities offered by a great many communities are usually attractive, but not essential for businesses. In contrast, small business equity capital is almost impossible for companies to obtain. Acquiring the proper equity funds is very often the critical difference as to whether a business can get into business, stay in business, or expand in a significant way.

Creative small business venture capital investment programs for inner-city, usually minority, areas that can offer reasonably priced (cost to the business) equity dollars while potentially safeguarding and enhancing the return of private investors offer a great overall potential. Innovative uses of public sector dollars and government investment guarantees provide a high potential way to proceed, including but not limited to the use of Community Development Block Grant (CDBG) funds.

Creative equity investment programs could aid inner-city neighborhoods in particuliar, but such programs could also strive to assist other central city neighborhoods with commercial strip business attraction and urban industrial revitalization.

It is our contention that small business equity capital investment programs to serve the redevelopment needs of urban areas could best be structured in three (3) ways: city grants to non-profit community development corporations for investment purposes in Small Business Investment Companies (SBICs); city guarantees of private investor participation in SBICs that service urban neighborhoods; and city operated programs of near equity small business investment activity, such as collateralized, convertible income debentures.

If $2 million to $4 million of the City of Chicago's Community Development Block Grant funds could be allocated to next year's CD program for such equity capital investment purposes, then much might be accomplished. Creating any of these small business investment programs would be a greatly enhanced incentive for urban economic development.

First, however, a team of technical consultants should be hired to present to the city the specific ways these investment approaches would be optimally structured. The consultants should be able to present their reports within 9 to 12 months, thereby enabling the actual aforementioned program implementation to begin within the next CD year (October 1, 1982 to September 30, 1983).

Grants to Neighborhood Non-Profits for SBICs

Small Business Investment Companies (SBICs) are for-profit, private venture capital companies licensed by the U.S. Small Business Administration. SBICs are able to leverage long-term, SBA loans against private capital participation for eventual long-term debt and equity capital investments in small businesses. U.S. Department of Housing and Urban Development (HUD) regulations permit Community Development Block Grant funds to be invested in SBICs. If the City of Chicago were to donate CD funds to neighborhood-based, non-profit community development corporations for investing in SBICs, then a significant source of urban small business equity capital could be created.

We would recommend that financial grants be provided to community organizations for them to take a voting but non-dividend stock ownership position in Small Business Investment Companies. Such a process would enable the neighborhood groups to have a voice in SBICs' investment policies and would multiply the investment return of other private investors that would participate in urban-oriented SBICs. Inducing private capital to participate in community development SBICs is the basic purpose. Multiplying the investment return of other private investors through the community groups taking a non-dividend position is a very high potential approach.

City Guarantees In SBICs

Establishing an investment loss reserve fund for private investments in SBICs offers another very high potential way to proceed. If the City of Chicago would guarantee private investor, particuliarly public pension fund and small investor, participation in SBICs and would establish an investment loss reserve fund to directly compensate investor claims, then a risk-free, fully leverageable investment mechanism would be created for urban small business development.

Establishing an investment loss reserve fund of $1 million to $2 million from the City's CD allocation would be a very constructive first step.

Since SBICs as individual institutions have experienced very modest failure rates, such a guarantee program could induce significant new private investment in SBICs at a very modest overall cost.

Direct Near Equity Investment Programs

To complement these more sophisticated SBIC investment programs, the City of Chicago may want to consider establishing direct near equity investment programs. The National Development Council (NDC) recommends that city governments consider issuing collateralized, convertible income debentures for urban small business development. These debentures enable the city government to make a near equity capital investment without being concerned about taking eventual control of a distressed small business. The terms of an income debenture, which is basically a loan, allows for a flexible maturity conditional upon some future occurance, such as profits or strong cash flow. Generally, cash flow will self-liquidate this investment. At the same time the debenture can be made convertible to common stock to allow the city to realize an appreciation of principal should the company be sold to another company or should it go public.

A convertible income debenture's debt service can be flexible. It can be triggered by success or held in abeyance during cash thin periods. The National Development Council recommends income debentures with a maturity not to exceed ten years.

A city government would want to protect its investment through collateralization. Therefore an income debenture, primarily a debt instrument, is the proper direct financing vehicle. The city government's protection desire, however, should not conflict with the company's need for a flexible repayment schedule while the finances of the company catch up with the company's faster rate of growth. Both needs can be satisfied through the near-equity income debenture.

ENTERPRISE DEVELOPMENT INCORPORATED

September, 1980

Dear Participant:

This economic study was prepared under the auspices of Enterprise Development Incorporated (EDI), a not-for-profit corporation experienced in Appalachian business development since 1961. The proposal addresses the critical venture capital shortage existing in the City of Chicago and recommends a "capital base" model to reverse Chicago's financial outflows.

The study was principally authored by James B. Patterson, EDI's Vice President. This Illinois project came about through persistent organizing efforts by Mr. Patterson, a long-term EDI consultant and native resident of Chicago.

From its community experience, Enterprise Development Inc. believes that traditional and general problems contributing to economic stagnation in any American community (i.e. education, communication, accessability, transportation) are being resolved. There yet remains the need, however, to stimulate private enterprise, which enlarges a community's own private capital base, while creating an opportunity for orderly/ecologically acceptable growth and broad-based equity ownership.

Public works programs are important for economic development; however, the building of new roads, for instance, does not automatically create job-producing industry nor business of a substantial nature. Wise public investment is important but the stimulation of private enterprise is crucial.

Enterprise Development Inc. recommends the establishment of a comprehensive Chicago economic development consultancy program for the expansion and more meaningful use of the 1958 Small Business Investment Act.

At the request of the late Honorable Hubert H. Humphrey, Co-Chairman of the Joint Economic Committee of the United States Congress, (S. 1055) a bill to declare a national policy on investment in the private sector -- "The Investment Policy Act of 1977" -- was introduced into the Congressional Record on 21, March 1977.

Among other alarming, disheartening facts, Senator Humphrey identified the dearth of new equity capital flowing to smaller companies, nationally only about $16 million of new public issues in each of the years 1974, 1975, and 1976. Senator Humphrey further stated, "The very foundation of our competitive enterprise system rests on the quality and scope of opportunities for the establishment of new business, specifically small business".

INTENTIONAL
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EDI recognizes as a basic tenet of our democratic society that our elected government, if it intends involvement in "Investment Policy", must provide mechanisms for the equal extension of opportunity. In a free capitalistic society, all persons must have access to all government programs which assist, or provide means for, the production of wealth.

The Congress in adopting the "Investment Policy Act of 1977" and the "Small Business Investment Act of 1958 (as amended)" is seeking the potential equitable distribution of opportunity.

After twenty years involvement in economic development, EDI continues to illuminate the dichotomy between governmental objective and beneficial results, thus EDI proposes the enclosed economic development "Delivery System".

Sincerely yours,

Albert K. Mock, President
Enterprise Development Inc.

CAPITAL BASE:

The Delivery System

September, 1980

This is an abridgement of a study prepared in 1976 for an economic development project in the City of Chicago.

Prepared by:

Enterprise Development Incorporated
The Oak Knoll
Damascus, Virginia 24236

CAPITAL BASE PROPOSAL

A Summary

This proposal presents the design of a free enterprise system to positively impact financially deteriorating communities, and proposes, in our opinion, a model of broad potential for the general economy. This approach offers, perhaps, the only opportunity available today, through creative uses of existing high-potential government programs, to substantially impact the economic development prospects of most depressed, deteriorating, and/or blighted communities.

This total program, including its non-profit development components, can become fully self-supportive through retained equity and service fees within just a few years. This program is not another "transfer" bureaucracy.

Our study documents a model system, requiring the formation of several Small Business Investment Companies (SBICs), eventually as many as feasible, each directly relating to a specific urban neighborhood or rural community and/or group of neighborhoods or communities.

In order to maximize competent management resources, while minimizing overhead and operating expenses of the several SBICs, this proposal recommends the formulation of a central non-profit management capability. The continuing management activity would be necessary pursuant to the organization and/or participation of several SBICs.

The basic objectives of a "Chicago Capital Base" are the following:

> Establish a voluntary consortium of small business investment activity in Chicago.
>
> Find, analyze and package profitable small business investment opportunities, utilizing the consortium's skills.
>
> Provide on-going management assistance ("after care") through direct program resources and in-kind consortium participation to the program's small business investment portfolio.
>
> Expand the investment ("capital base") scope of the consortium, by forming new capital companies, and extend the Chicago Capital Model to other urban and multi-county rural areas.

This project does not seek to exercise final jurisdiction regarding specific consortium members loans or investments, only to assist through technical advice the decision-making processes of such a voluntary association.

Creative use of Section 110.1 of the U.S. Small Business Investment Act of 1958 (as amended) permits a potential 3 to 1 direct match, as long-term SBA loans, for each private dollar invested in the Small Business Investment Company (SBIC) program. In other words, one private dollar invested in an SBIC can directly create four (4) dollars for later investment purposes, including equity ventures.

Equity-type investments in manufacuring and most service operations can be leveraged about 3 to 1 through other business loans. Equity investments in real estate development can often be leveraged 10 or even 12 to 1. One private dollar, in other words, which is invested in an SBIC, can often be leveraged for business development purposes from 20 to even 30 to 1 through creative use of this high-potential and indeed important legislation.

When one considers that the SBIC program history, particularly the well-capitalized companies, has proven to be a high-potential investment approach, then the further leverage potential inherent to the legislation, if perceptively managed, points to an extremely important direction for local economic development.

In short, a successful "capital base" program (no legislative amendments are needed for implementation of a broad-based program) can significantly address the dilemmas of community and central city disinvestment and decline.

ACKNOWLEDGEMENTS

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Combined Opportunities, Inc.
The Urban Fund, Inc.
Tower Ventures, Inc.
Chicago Community Ventures, Inc.
CEDCO Capital Corporation
AMOCO Venture Capital Company
TRUST, Incorporated
The Woodlawn Organization (TWO)
West Side Organization for Full Employment (WSO)
Tri-Faith Manpower Employment and Training Corporation
Chicago Urban League
Pyramidwest Development Corporation
Kenwood-Oakland Community Organization (KOCO)
Christian Action Ministry (CAM)
HICA Corporation of North Lawndale
Fifth City Industrial Corporation
Chicago Association of Neighborhood Development Organizations
Continental Illinois National Bank and Trust Company
First National Bank of Chicago
Hyde Park Bank and Trust Company
Industrial Council of Northwest Chicago
Greater Westside Development Corporation
Chicago United
Combined Insurance Company of America
American Hospital Supply Corporation
Institute of Urban Life, Loyola University
Center for Urban Affairs, University of Chicago
Center for Urban Economic Development (CUED), University of Illinois at Chicago Circle
Center for Urban Affairs, Northwestern University
W. Clement & Jessie V. Stone Foundation
Church Federation of Greater Chicago
Jewish Coundil on Urban Affairs

The authors, however, assume full responsibility for the accuracy, opinions and conclusions reached in this report.

THE UNIVERSAL PROBLEM

Purposeful economic development that helps create new tax-generating employment, modernized competitive enterprises, and new base wealth is important to the solution of our nation's most serious economic situation.

In 1969, Enterprise Development Inc. management gave testimony to the Congress on the crucial need for new "capital bases" in depressed American communities. The need for far-reaching "capital base" activity is even more paramount today as witnessed by the following socio-economic trends.

Community Decay and Depression

Today, urban America faces a special crisis. A modern social cancer of decay threatens to engulf more and more urban neighborhoods. It results from numerous highly complex factors, in which neighborhoods often find themselves trapped in downward spirals of deterioration. These spirals expand, draw in peripheral areas, and drain the neighborhoods until they cease to be viable human settlements.

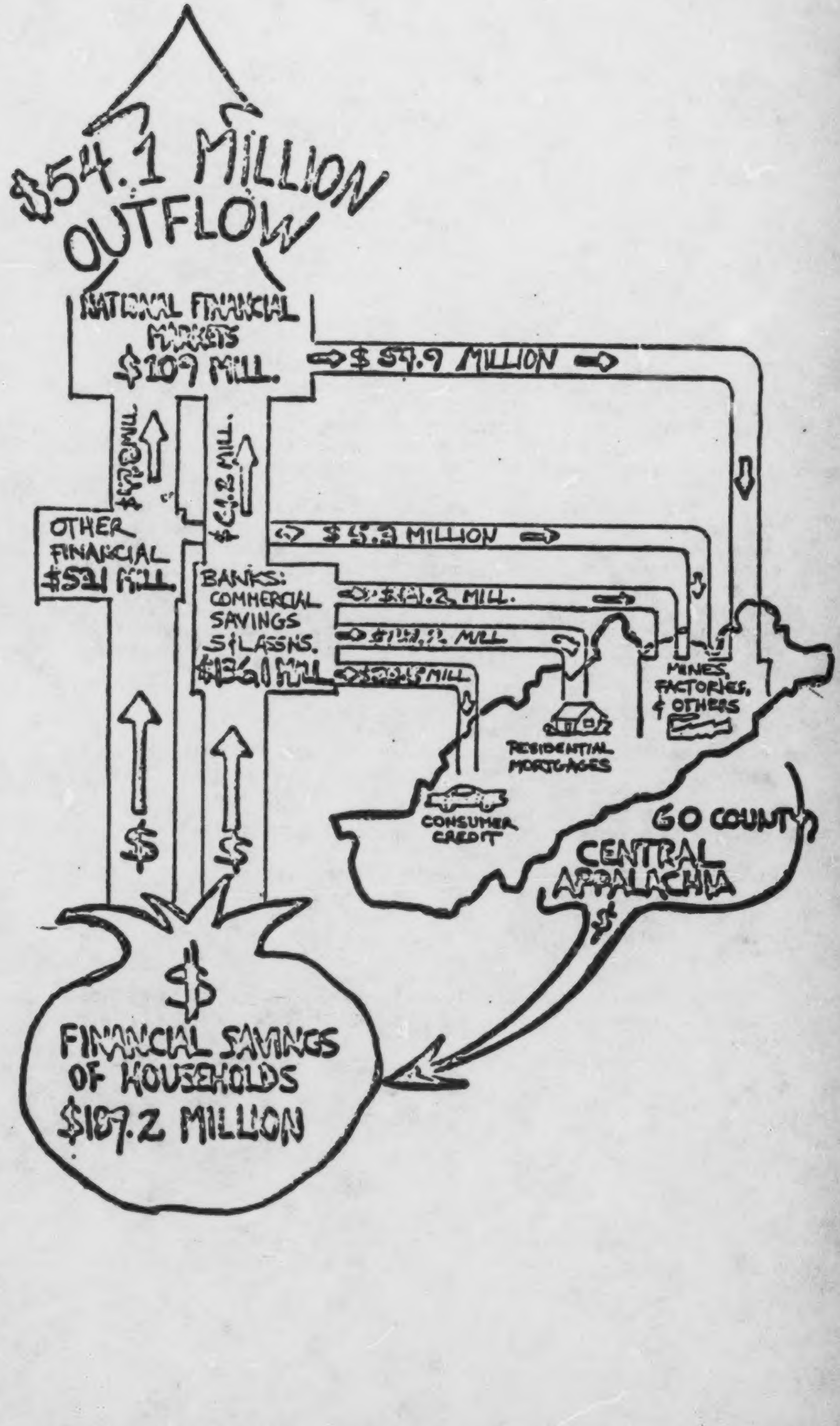
This rapid rate of decay is a paradox. In the midst of unprecedented national wealth and proliferating programs to halt deterioration, decay has accelerated and few solutions emerge. Good housing succumbs to slums, profitable businesses leave or go bankrupt; schools deteriorate, and crime increases.

Although residential deterioration and housing abandonment require special remedies, the root cause of urban decay is community economic depression(i.e. lack of jobs, poverty, and flight of industry).

In March 1969, a study entitled The Availability of Capital in Central Appalachia by Checchi and Company, a Washington-based economic consulting firm, was submitted to the Appalachian Regional Commission. It reported that in calendar year 1967 there was a net capital outflow from a sixty-county sub-region of $54 million. Obviously, this is an absurd circumstance if economic development of Central Appalachia is desirable as a national goal. (See chart, following page)

In urban America, the best-known aspect of this phenomenon is "redlining", by which financial institutions map many city districts "off limits" for loans, mortgages, and insurance. Prospective property buyers in redlined neighborhoods are denied loans and insurance regardless of their income or credit rating.

Yet, as the Checchi study clearly demonstrates, without being redlined, a depressed community usually lacks an aggressive methodology to invest local residents' savings.


$54.1 MILLION OUTFLOW
NATIONAL FINANCIAL MARKETS $109 MILL.
$54.9 MILLION
$64.2 MILL.
OTHER FINANCIAL $521 MILL.
MILLION
BANKS: COMMERCIAL SAVINGS S&L ASSNS.
MILL.
MILL
MILL
MINES, FACTORIES, & OTHERS
RESIDENTIAL MORTGAGES
CONSUMER CREDIT
60 COUNTY CENTRAL APPALACHIA
$
$
$
$
FINANCIAL SAVINGS OF HOUSEHOLDS $107.2 MILLION

Inner-city (minority) unemployment is worsened today by the general decline of the urban economies. Chicago has, for instance, 212,000 fewer manufacutring jobs since 1969. Since then, New York City has lost 650,000 manufacturing jobs. From 1970 to 1975, 248 manufacturing plants left Detroit, including branches of the 16 largest local companies.

Roughly 50% of employment in the large cities comes from the small business sector. Local economic development programs, whether run by the city government or private organizations, stand a far greater chance of influencing small business investment decisions than effecting the choices of the giant corporation.

The ultimate solution to urban blight is a matter of capital flow, particularly new small business investment. To reverse the trends, new investment capital institutions, which serve the central cities and other depressed American communities, must be created.

Small Business Development

The 13 million small and independent businesses in this country represent a much more important segment of our economy than is generally recognized.

Many of the staples of our developed society were introduced by small business. Air conditioning, power steering, light switches, helicopters, photocopy machines, FM radio, all were the work of independent entrepreneurs. These products typify the ingenuity of small business. In fact, over one-half of all technological innovations have been derived from the small business community.

A recent study by the National Science Foundation found that small businesses are 24 times as creative as big companies when measured by the 300 most significant technological innovations of the last 20 years. Other studies like the Jewkes study of inventions, the Peck study of the aluminum industry and the Enos study of petroleum innovation back this up.

And another fact not to be disputed: over half of all private sector employment comes from small business. In fact, a Congressional study has shown that over 90% of the employment gains of the last 20 years have come from companies that are not in the Fortune 500.

It's the small, labor-intensive businesses that are doing the hiring, and it's the small, labor-intensive firms that are most likely to take on the unskilled and semi-skilled workers who are the crux of our unemployment problem, and allow them to apprentice in the skills that will keep them in the job market.

Although we recognize many of the virtues of the independent small business sector, we are failing to recognize the flood of acquisitions which is lessening their independence and increasing our overall industrial concentration.

Smaller and medium-sized businesses are threatened as never before. In 1948, the 100 largest companies accounted for 44.2% of manufacturing assets; but, by 1972, this had been increased to more than 2/3 of the assets, and the trend is worse every year.

Capital for start-up and expansion of businesses is becoming alarmingly scarce. Last year there was a drop of 50% in equity issuances by companies with a net worth of $5 million or less. In just 5 years, capital raised by small business under the SEC's "Regulation A" has dropped two thirds. The trend looks even worse when we turn to other forms of capital-raising. Initial public offerings by small business: down 92% in 5 years. Underwritten public offerings for small business: down 95% in 7 years. With capital from outside investment drying up, small businesses have been increasing their debt precipitously. Many have gone under. Countless others have never even been formed or entered the marketplace.

The table below illustrated the precipitate decline in public offerings involving companies having net worth of $5 million or less:

Year	No. of Offerings	Total Dollar Amount (in millions)
1969	548	$1,457.7
1970	209	383.7
1971	224	551.5
1972	418	918.2
1973	69	137.5
1974	8	13.1
1975	4	16.2

Over 300 high-technology firms were formed in 1968. Not one was formed in 1976. Not a single one. And fifteen of the most promising ones were partially or wholly bought out by foreign capital last year -- sending their growth benefits overseas.

Canada provides an example of what might happen. Canadian historian J.J. Browne has listed over 100 inventions -- among them the telephone, the piston valve, the zipper, and the electron miscroscope, which he says "slipped through Canada's fingers." These Canadian inventions went abroad to be developed by other nations.

To increase the flow of capital into small business, we've ultimately got to increase the incentives for people to put their money in savings.

Americans are currently saving and investing about 5% of their incomes. In West Germany, by contrast, the rate is more than 15%. In Japan, people are saving almost 25% of their incomes. It is no wonder that, among the world's industrialized nations, we have the highest percentage of obsolete production facilities, the lowest ratio of capital investment to GNP, and the lowest rate of productivity increase.

As the supply of capital has dwindled, the system which channels capital into business has become more and more centralized. In recent years, the individual investor has become an endangered species. More and more investment money is being channeled into business through financial institutions, which are less and less willing to invest in small businesses. And the securities industry, which links investors and businesses of all sizes, has been contracting and consolidating.

Since 1962, deposits in the nation's ten largest banks have increased from 20 to 33 percent of all deposits. This is significant because big banks are usually reluctant to lend to small businesses.

Until the mid-1950's, individual investors were the largest net buyers of stock. Then institutions began to assume the lead. Now, more and more individual savings flow into capital markets through these financial intermediaries -- and that tendency is increasing:

--- Institutional control of common stock has increased from 15% to 30% in just two decades.
--- In 1976, institutions were responsible for about 70% of public volume on the New York Stock Exchange, while indiviuals were responsible for only 30%.
--- In 1976, five out of every six equity dollars were invested by institutions.

At the same time, the network of brokerage firm sales offices serving individual investors has been shrinking.

Not only are there fewer securities firms, but the largest of those that remain are doing more and more of the business. Fortune reports that the top 25 firms accounted for 54% of the industry's brokerage revenues in 1977. Just five years before that figure was 31%. When a securities firm closes a branch office, more often than not it is closing the door to some sources of small business capital. The industry's branch office network has been the life support system for the nation's smaller businesses.

People want to live close to their jobs. They want service and shopping amenities close to their homes. They still prize craftsmanship and face-to-face relationships with business owners. And like all Americans since the founding of this country, they believe in entrepreneurship. Those are values we ought to encourage.

Minority Enterprise Development

An important goal in recent years has been to significantly increase minority business ownership.

In 1967, non-whites comprised 15% of the American population, but in the category of "managers, officials of business, and proprietors", they comprised only 2.7% representation. There are only two black-owned companies in the country whose common stock is publicly traded. Within the largest 1000 corporations, there is not even one non-white-owned business.

The most disturbing aspect, however, about many activities to solely assist racial minorities is that the vast majority of the white population don't own any business assets, nor are they proprietors, officials, or managers of business enterprises.

America will probably not have the will to solve these problems until "compensatory capitalism" benefits all Americans. This proposal lays the theoretical groundwork that holds rich potential for every business, neighborhood, and small investor.

Broader Business Ownership

The American economy will require tremendous business investment capital in future years to maintain past rates of economic growth.

The United States capital demand through 1985 will total at least $5.69 trillion, according to a 1974 study completed by the New York Stock Exchange (NYSE). Another study (December, 1975), completed by the Exxon Corporation predicted the U.S. energy industry will have to find more than a quarter-billion dollars a day for the next decade to finance expansions to meet demands for oil, coal, gas and electricity in 1990, projected at $1 trillion.

American business, however, is now in a heavy debt rather than equity financing position and the debt institutions are finding it increasingly difficult to assemble capital for further debt financing.

The debt to equity ratio for U.S. manufacturing companies has more than doubled in the last two decades. According to SEC and FTC data, U.S. manufacturing companies were in debt in 1955 at 21 cents for each dollar of equity held; by 1974, debt had soared to nearly 44 cents. This debt situation with its requisite interest obligations is placing significant profit-margin, return-on-investment, and liquidity pressures on many American businesses, including some of our largest corporations.

Between 1969 and 1973, non-financial corporations in the U.S. invested nearly $540 billion. About $290 billion came from depreciation, $60 billion from retained earnings, and a net $50 billion from stock sales. On the debt side, a net $75 billion was raised by bond issues and another $75 billion through bank loans and commercial paper. In other words, debt financing outpaced new equity financing by approximately 50% as much and equity financing through stock sales accounted for only 7% of total investments.

The solution to this dilemma is to make capital more easily obtainable in the form of equity: to increase the incentives to save and place savings in equity forms of investment.

The most prominent proponent for increasing equity business ownership amongst the general population is Louis O. Kelso, a San Francisco lawyer, who has for two decades been proposing his Employee Stock Ownership Plan (ESOP).

Five years ago, Senator Russell B. Long, Chairman of the U.S. Senate Finance Committee, guided ESOPs into two pieces of legislation: the Employee Retirement Income Security Act of 1974 and the Tax Reduction Act of 1975, which offered a 1% investment tax credit to any corporation with an ESOP meeting certain standards.

In theory, economic philosophers generally believe that diffusion of corporate ownership is desirable in a free market, private enterprise economy. Expanded ownership of stocks has begun to seem, to many, not merely desirable but essential to reduce alienation from business, including effecting productivity, wage conflicts, vandalism, absenteeism, labor-management relations, and potential government regulation and/or intervention.

To enhance the private market economy, Kelso advocates better tax advantages for investment income and much improved ESOPs having greater resources. To attract business, Kelso proposes the government provide low cost credit to corporations adopting comprehensive ESOPs.

Enterprise Development Inc. feels that consideration needs to be given to some other ideas. Two amendments to the U.S. Small Business Investment Act of 1958, plus a substantial field "delivery system" for the legislation would, in our opinion, accomplish many additional benefits.

EDI believes that government should guarantee private citizens investments in SBICs through a mechanism like the Federal Deposit Insurance Corporation (FDIC). The second amendment would eliminate company-size requirements regarding these guaranteed funds for a portion thereof, allowing financings made by SBICs to any size business, including equity deficient major corporations.

Such a program possesses the following advantages:

- encourages significant broad based capital formation.
- provides a major new equity capital source.
- increases investor security by diversification of investments, extension of ESOP concept, and new guarantee provisions.
- encourages capital formation via private savings.
- maximizes small and large business sectors.
- permits alternative investments, optimizing available capital.

The Capital Base Model

Enterprise Development Inc. has conceived an economic development plan based on experience in Asia and Appalachia and, more specifically, development of the Iron Mountain Stoneware plant in Laurel Bloomery, Tennessee. Reader's Digest (March, 1968) called the stoneware plant an "Awakening in Appalachia". The article explains how a federal business loan and federally funded training program, combined with local private capital and good business management created 45 jobs for the so-called "untrainables" while producing a quality product with a profitable national market.

A study appearing in Mountain Life & Work, an Appalachian magazine, regarding "investment multiplier effect", indicated that the Iron Mountain Stoneware Plant had a local economic development impact multiplied by a factor of five. This was based on the assumption that people and businesses spend about 80% of their income locally (historical data show that in the United States about 92% of income is spent).

A local capital investment of approximately $100,000 (some $281,000 inital total funding) at Iron Mountain tended to raise the income in the area by an extra $500,000 within one and one-half years, using the multiplier factor of five. Additionally, at Iron Mountain, approximately 180,000 new dollars were injected annually into the local economy through wages and salaries. Using the same "multiplier effect" ratios of 80% and five, we obtain a figure of $900,000 as the ultimate rise in annual income for the area. Moreover, the local purchase of raw materials and supplies injects $40,000 and its requisite multiplier. Thus, Iron Mountain Stoneware, while fairly small, has become a significant economic factor in Johnson County, Tennessee. It is important to note that Iron Mountain equity is held locally which creates an additional multiplier usually missing with absentee ownership.

Background

We began with proven concepts supplemented by experience and well-founded knowledge of a given region. Our project spread logically over a wide range of development facets -- until we believe it now has real promise for all American communities. People of diverse backgrounds and a wide assortment of talents have contributed to this growth.

The starting point can be traced to the experience of the Council of the Southern Mountains with an entity called Cannon Industries in Barbourville, Kentucky. This was an attempt to start a grassroots woodworking industry in a recognizably depressed area of Appalachia. Through trial-and-error activity, local people formed a somewhat cooperative enterprise. Modest success was achieved.

The first delineation stage was achieved in the spring of 1967. The Council decided to join its own knowledge with the experience gained at the Iron Mountain project, bringing together Albert Mock and Gerald Osborne, the Council's representative with the Cannon Industrial Project. The project was further aided by paid consultants and an unpaid legal advisor, Professor Eugene F. Mooney of the University of Kentucky Law School.

An Idea Develops

In essence, as we moved more deeply into our study, our point of view, of necessity, became enlarged.

Anyone concerned with an economic development project -- large or small-- becomes aware of three segments of basic concern:

The availability of competent manpower.

The availability of adequate management or people with entrepreneural experience.

The availability of investment money.

The proven experience of many people in industrial development reveals that the potential for acquiring "skilled manpower" is good -- it is available throughout the nation -- but the presumed "unemployables" must receive well-managed training designed to fit specific opportunity or proven demand.

Again, skilled management is to an extent available -- though not always in the place of greatest need; often it is dispersed over a given region and must be recruited for each specific project. In many instances, managerial talent must be imported from other parts of the nation.

There is one real problem of immediacy: the availability and realization of investment capital -- or -- the lack of a capital base in a given area. The problem does not long remain unrecognized by anyone whether "native" or "outsider".

While identifying potential trial geographic areas in Appalachia, EDI became acutely aware that there was no adequate financial base for small business development in the areas of greatest need. In other words, a depressed area does, by definition, suffer from a lack of risk or equity capital. Conventional loans are readily available pursuant to collateral ability, but this obviously does not meet working capital requirements.

The single, most glaring deficiency relative to capital base and individual economic opportunity is the lack of equity ownership amongst the residents of any region.

The EDI staff, subsequently, has developed a promising solution to the basic problems of capital availability and broad-based equity ownership. This approach provides large possibilities, we believe, for Appalachia, the urban inner-city, and many other underdeveloped areas of the United States.

The plan would implement, through a well-designed "delivery system", the Small Business Investment Act of 1958 (as amended), tapping large regionally captive industrial interests and conventional financial institutions for the first private sector investment increment. Following establishment of an investment company under the Act and the commencement of the acquisition of a small business investment portfolio, additional public offerings would utilize a "mutual fund technique", i.e.,"$10 per month ownership in twenty enterprises close to your home, one which may, perhaps, have a job for you."

The plan envisions the creation of many area investment companies and the additional construction of an overall management or "Technical Assistance" umbrella (Ref: Courier-Journal, Louisville, Ky., 16 February, 1968, "Appalachian Investment Plan Urged").

Application to Depressed Areas

It is generally accepted that one of the underlying causes of economic depression is inadequate capital flow generated by the return of profit to a given area. Additionally, a dearth of investment capital precludes economic development.

Small Business Investment Company (SBIC) capital stock, when sold to the greatest number of people in a given depressed area, would provide equity ownership with prospects for a return of profit, while diversifying investment interest and creating new enterprises, new job opportunities.

Unfortunately, affluent investors are usually not available in depressed areas and the "money market" is, for the most part, traditionally managed.

Yet, the "mutual funds" have been successful historically in acquiring investment capital from uncommon sources by initiation of monthly investment plans applicable to individuals of various income levels. Other investment mechanisms tailored to people with limited financial abilities are equally relevant.

EDI envisions a $3 million (minimum) realization for each capital company through the broad distribution and sale of securities on a monthly basis. However, this sales activity should be projected over a minimum five-year period, if the primary customer is to be of the medium or low-income group prevalent in the underdeveloped area. Therefore, if a depressed area would seek to gain the advantages of the legislation and facilitate from within the development of new opportunity, a method of initial (or first offering) financing will have to be devised.

There are many resources which could be mobilized in the initial capitalization while furnishing management and directional assistance during the formative and operational periods. EDI experience indicates that the Appalachian business leadership and financial community can be responsive and EDI feels the national climate is now, more than ever before, conducive to such development activities.

-Private organizations having significant assets and vested regional interests:

Consolidated banks and conventional financial institutions including mutual funds.

Private and public utilities.

Manufacturing firms. requiring an area for raw materials, labor or markets.

Large retail and distribution organizations, i.e. Sears, the food store chains, and the oil companies.

Union and other organizational funds.

Religious and national philanthropic organizations.

-Private organizations having modest assets and vested area interest:

Local banks.

Local Industrial Councils.

Smaller retail organizations.

Local Development Organizations.

Professional people and trade organizations.

Transportations companies.

Construction industry.

Regional philanthropic organizations.

State and municipal governments might provide initial funds, especially multi-county economic development organizations, industrial bonding agencies, local industrial commissions, and Community Development Block Grant (CDBG) agencies.

To deliver skilled management, while minimizing overhead and operating expenses of the several investment companies, we envision the formulation of a management organization to supply directly or via consultants: technical assistance, accounting services, investment counseling, legal services, project analysis, overall advertising, promotional activities, etc. This continuing management activity would be necessary pursuant to the implementation and/or cooperation of several SBICs. The core management would not provide final jurisdiction regarding specific "members" loans or investments; however, it could assist in decision-making to the participating SBIC directors and managements.

The SBIC legislation provides for joint investments, thereby increasing financial impact. This management system could supply supervision and management for such a joint investment or consortium program, involving SBICs, community development groups, and other financial organizations.

"Start-up" financial and other in-kind service support for the core management organization could be underwritten by initial SBIC sponsors

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in concert with philanthropic foundations, social organizations, and government agencies. The program has, however, the potential of becoming self-supporting through retained equity and service fees.

Upper Cumberland Investments, Inc., an SBIC organized through EDI's efforts in Appalachia, represents, to our knowledge, the first utilization of a Small Business Investment Company by a multi-county Development District for the future economic development of a depressed area. Significantly, the legal construction of Upper Cumberland was of such design as to permit broad-based equity ownership by citizens of the Tennessee Cumberland area.

Provisions for broad ownership and management participation were legally insured in this fashion:

> First, the initial investors (twenty area bankers) agreed to "cumulative voting rights" in the selection of the board of directors, thus insuring minority participation.
>
> Second, the initial investors waived "pre-emptive stock purchase rights", providing for broad distribution of the proposed second offering of common stock.

During the many organizational meetings of this SBIC, full discussion was entered regarding techniques for involving a maximum number of Tennessee citizens in the ownership. While impossible, prior to SEC registration, to insure broad equity participation, it was the sense and general intent of the original investors to develop a feasible method for such participation.

Upper Cumberland Investments, Inc. is the institutional model, in our opinion, for many underdeveloped American communities needing a method of stemming capital outflow.

Marketing, Technical and Legal Strategy

Suggested methods for realization of functional SBICs:

1. Review the SBIC concept with knowledgeable financial and development people, attorneys, and federal officials, including the Securities and Exchange Commission and the Small Business Administration.
2. Organize meetings with regional "financial interests", i.e. bankers, power companies, industrial representatives, etc.
    - A. Secure technical and management support
    - B. Secure pledges of maximum possible financial participation
3. Select feasible "pilot areas".
4. Organize meetings of the "financial interests" within the proposed "pilot areas".

   A. Establish management support systems
   B. Secure investment funds

5. Incorporate and obtain SBA license.

   A. Establish boards of directors
   B. Retain management
   C. Banks and local initial investors become "investment finders"
   D. Call pledges

6. Commence investments -- build broadly diversified investments within areas of operations including investments in existing profitable businesses.

7. Commence maximum distribution of secondary securities, providing local people investment programs tailored to their means, utilizing conventional stock sales plans perfected by mutual funds.

8. Manage the investment portfolio in such manner as to produce returns for distribution to stockholders.

It is feasible that with the intelligent use of other existing local, state and federal legislation, this program could produce, within the next ten years, millions of dollars for investment within each region where a "capital base" program is established, returning to a maximum number of non-owners a direct dollar return while providing new entrepreneural opportunity and income.

Capital base marketing activities are as varied as the communities in which the program operates. Whereas the legal mechanisms can be clearly delineated, the stimulation of the idea is subject to individual personalities, local civic politics, and regional economics.

An important task of the promotional staff will be the organization of commitments from the original target groups mentioned earlier. The promotional staff will have the responsibility to coordinate the entire effort toward the realization of the several licensed and successfully operating capital companies.

PERFORMANCE DATA
SMALL BUSINESS INVESTMENT ACT 1958

Few people realize the rarity of a new financial industry. For example, state banks date to 1781; national banks to 1863; the first savings and loan association was established in 1831, and the first insurance company traces its history to 1759.

Congress has, however, repeatedly enacted creative legislation filling gaps and needs in the financial community; namely:

- federal mortgage guarantees
- federal reserve
- federal deposit insurance

SBIC Legislative Origins

In 1950, a Small Business Investment Act was supported by the Truman Administration, which called for the creation of capital banks for small businesses within each Federal Reserve District. The Korean War interrupted consideration of the legislation.

From 1950 to 1957, Senator Sparkman of Alabama and others introduced at least twenty-five bills designed to create special institutions to aid small business. In all, some three hundred bills had been introduced in Congress from 1935 to 1955.

In 1953, Congress created the Small Business Administration to insure that smaller-sized companies could obtain long-term loans. However, SBA was not empowered to make equity-type investments.

At the U.S. Senate's request, the Board of Governors of the Federal Reserve began a study in 1957 on small business.

The study concluded that there was no institutional source of equity financing for small businesses. Banks, insurance companies, and other lenders could not make risk-type investments unsupported by collateral or the business's financial strength. Underwriters could in reality sell stock to the public only in larger companies with proven records. While a few wealthy families and a few special companies served these purposes there was no organized institutional source of equity capital. Without such a source, the Federal Reserve felt that availability of financings was highly uncertain.

By 1958, Senator Sparkman had proposed legislation for a specialized source of equity capital. Discarding the capital bank concept, the new plan encompassed privately operated investment companies that would be provided certain tax benefits and borrowing rights from SBA.

The result was one of the very first government programs to recognize the need for private capital to accomplish what could not best be done by the government alone. The Small Business Investment Act became law 25 years after legislative labours were begun in its behalf.

The Legislation

The first ground rules for Small Business Investment Companies (SBICs) were experimental, since the government had not previously entered the complex venture capital field.

Originally, SBICs could only invest in convertible debentures. This limitation, changed in 1960, indicated Congress did not realize venture capital requires maximum flexibility. As restrictions are imposed, this form of investment activity becomes less attractive.

Initially, an SBIC could borrow only $300,000 from the SBA. The inital SBA lending provisions of $300,000 contradicted testimony from experienced venture capitalists, who strongly urged that SBICs should have a minimum of $3 to $5 million in capital to be effective.

Amendments have changed numerous aspects of the SBIC program over the years. For instance, Public Law 92-595, approved October 27, 1972, increased SBA assistance (from $10 million to $15 million) for two-to-one leveraged SBICs and to $20 million for three-to-one leveraged equity-oriented SBICs (those SBICs placing 65% of capital in equity investments). Moreover, the 1972 Amendments gave statutory recognition to SBICs investing exclusively in small concerns owned and managed by persons whose participation in the private enterprise system is hampered by social or economic disadvantages (the MESBICs).

This legislation continued a record of favorable action to the Small Business Investment Act in every Congress, since the original bill in 1958. It attests to the program's positive trend of congressional support.

Growth of the SBIC Industry

From 1960 to 1962, the SBIC industry experienced intensive growth. President Kennedy had SBA conduct an intensive campaign to bring the SBIC program to the attention of the financial and business community.

Between June 1960 to December 1961, 47 publicly-owned SBICs were formed, in which the public invested $350 million. At the height of the rush, a number of publicly-held SBICs had very significant price gains, and some of the nation's leading commercial banks formed wholly-owned SBIC subsidiaries.

During this phase, the SBICs drew the attention of real estate brokers and investors. Under the initial provisions, nothing prevented SBICs from making loans in a variety of real estate situations. Many real estate dealers, speculators, promoters, et al desired the SBIC program to gain leverage for their own capital. Furthermore, real estate was probably a more practical investment medium for a small SBIC than complex, high-risk venture capital investments.

A third type of SBIC was formed by people primarily interested in high-interest rate loans. These companies made loans (SBA allowed) at 12 - 15% interest, secured by second, third mortgages and other collateral. Smaller SBICs could more easily function as finance companies than as venture capitalists, and the initial basic SBA stimulus to form smaller SBICs again encouraged the formation of such firms.

Unfortunately, poor licensing standards, excessive SBA regulatory actions, overly optimistic investor expectations, and some basic legislative weaknesses created problems for the SBIC industry. From 1962 to 1970, new SBIC growth slackened, and the industry consolidated.

By mid-1965, however, signs pointed to improved SBIC performance. Throughout the period 1967-1968, SBIC investments sparkled. The SBICs outperformed the leading growth-type mutual funds.

Costs and Benefits

By 1974, the SBIC industry had invested approximately $2 billion in at least 40,000 small business firms, and the Federal Government had realized a net gain from the program.

By 1974, less than $25 million in government loan losses were written off and SBA administrative costs annually averaged but $2 million; however, SBICs had paid about $46 million in Federal taxes. With the additional taxes paid by their portfolio companies, suppliers, and employees, Federal revenues far outran government outlays. There are very few government programs recording that claim.

Small Business Administration studies report for every dollar of financing provided by SBICs, small businesses have raised additional funds from commercial banks and insurance companies in the ratio of 1.35 to 1. For every SBIC dollar invested, businesses have been able to increase their short-term debt by 55 cents and their long-term debt by 80 cents.

In early 1970, using the 1.35 to 1 ratio, the SBIC industry, which had invested $1.3 billion in small business, helped the companies borrow an additional $1.7 billion, thus contributing about $3 billion. By 1970 the government had loaned only $248 million to SBICs. The government had achieved a leverage ratio of 12.5 to 1 from its SBIC seed money.

By 1970, SBIC funds had helped create at least 300,000 new small business jobs. Based upon $248 million government loans to SBICs, 300,000 jobs were created at a government cost of about $1000 per job, which very favorably compares with any government welfare program. Note the government's cost represents an investment being repaid by the SBICs, so actual cost/per/job is reduced well below the $1000 average.

Moreover the SBICs contributed greatly to small businesses from mid-1962 through 1966, when virtually all investment bankers previously active in venture capital lost interest. The investing public (which had lost heavily in small companies) ignored underwriters. SBICs were one of the few continuous sources of equity funds for smaller businesses.

Thus, an additional benefit of the SBICs is being a contracyclical balance for small business financings in the fickle money market.

Structural Analysis

New licensings of SBICs averaged only ten per year in the late 1960's. This compared negatively to 194 licensed in 1961 and 298 in 1962. From a peak of 722 SBICs in existence in 1964, the number dropped to 454 in 1970 and further to 339 in 1976.

Several weaknesses in the SBIC industry continue to persist:

> The average Small Business Investment Company is too small, too financially limited to independently generate the income necessary for overhead and a satisfactory return.
>
> The government inducements offered to investors under the original legislation did not attract a satisfactory volume of private capital.
>
> Existing SBICs (perhaps seeking to generate suitable return to meet expenses) have tended toward financing of a debt nature rather than the intended equity-type investments.

A primary SBA recommendation has been to raise to one million dollars the minimum capital required to license an SBIC, tending to alleviate one weakness.

Congress has not followed this SBA recommendation, although a 1967 SBA study showed a minimum capitalization of $1 million is necessary to constitute a sound organization ("to assure adequate income, to employ competent management, to make the company attractive to private investors, to allow diversification of investments and to enable an SBIC to have reasonable expectations of a successful long-term operation").

By selling its debentures to the Small Business Administration, an SBIC (at least 65% of its available funds in investments of an equity nature) can obtain up to $20 million of federal financing. Obviously investment of 65% in equities (which in many instances will not generate immediate return) necessitates prudent allocation of income generated from the remaining 35%. Initial minimum investment levels would tend to constrain the generation of overhead, management expenses and potential dividends.

This method of financing is still the responsibility of the individual citizen, financial organization, or development group in a specific geographical area, therefore, SBICs are usually created only randomly.

Our analysis concludes that the SBIC industry has never been organized to its potential. For instance, the industry initially attracted numerous high-risk-minded speculators, real estate operatives, and high interest loan companies.

Moreover, joint ventures by groups of SBICs have been the exception rather than the rule. Joint efforts could share development costs of investments and spread the financial risks undertaken. To our knowledge, no program to effect such an inter-relationship exists anywhere in the country.

Financial Analysis

The principal objective of a risk-capital SBIC is capital gains. In judging the profitability of such a business, the same analysis applies as is used in mutual funds analysis. Profits are generated from income, capital gains realized, and appreciation on investments that have not yet been sold.

Through compilation of SBA data, the relationship is demonstrated between the net worth of SBICs and profitability. Over the period 1961-1969, our first period of analysis, the average capital of the SBIC industry was $376.2 million. Operation expenses resulted in an average annual loss of $5.2 million. However, since $5.1 million was annually generated in operating income and realized capital gains, the industry about broke even compared to its operating income and expenses.

However, on March 31, 1969, the industry had gained $176.6 million in capital appreciation, therefore the SBIC industry showed an average return per year of 5.02% on its net worth (1961 to 1969). Compared to commercial banks averaging 10 to 15% per year, commercial finance companies returning about the same, and manufacturing companies usually returning between 10 to 20% per year to invested capital, the SBIC industry's performance had been only respectable.

However, if only the years 1966-69 are studied, the analysis indicates SBICs generated significant financial gains. Thus, companies which survived the early years and developed reliable management have been solidly profitable financial institutions, substantially out-performing the Dow Jones.

In 1969, the after-tax return to invested capital of the entire SBIC industry was 9.5%, and the return for 329 companies licensed more than 5 years was 11.0%. Analyzing the larger capitalized SBICs, those with more than $1 million and $5 million capital respectively had 11.1% and 12.4% rates of return, and these larger companies which had been licensed more than 5 years, had returns of 12.1% and 15.8% respectively.

The SBIC industry is effected by downturns in the economy, as are most investments. Consequently, recent times have slowed SBIC financial growth, although the post 1974-75 recovery has brought substantial gains to the industry.

Most people would conclude that a group of companies, which had out-performed the Dow Jones and had assisted small business at a reasonable cost to the government, would now be a howling success. Unfortunately, the SBIC industry, with its many social-economic benefits, may be lost because of attrition.

Section (301) (d) SBICs (MESBICs)

In August 1969, a new SBIC program called MESBICs (Minority Enterprise SBIC) was created. These companies received full statutory recognition in 1972 and were retitled 301(d) SBICs, although the name MESBIC has remained the popular title of the program. There are approximately 75 licensed MESBICs which have usually been formed through financial donations by large corporation.

These SBIC licenses are obligated to invest solely in small enterprises owned and managed by persons whose participation in the free enterprise system is hampered by social or economic disadvantages. These specialized SBICs may receive financial loans from SBA in the same ratios as SBICs, but without absolute dollar limits and may, at their option, be further leveraged by SBA in part through the purchase of preferred stock within the overall leverage limits, on a basis of one dollar of preferred stock for each dollar of private capital in excess of $300,000, and for the entire private capital if it exceeds $500,000. The preferred stock is nonvoting and carries a cumulative dividend of 3%. When the 301(d) licensees issue debentures, the debentures can be purchased by the Small Business Administration, which carry a five-year interest subsidy of three percentage points below the interest contemporarily charged to regular SBICs, with a minimum of 3%.

In addition, the 301(d) SBICs are able to leverage the capital they do invest four to one through loans from commercial banks that are guaranteed up to 90% by the government. The MESBIC program is directly able to generate a twelve to one leverage of its private capital.

On October 8, 1975, the U.S. General Accounting Office (GAO) reported on the 301(d) SBIC program. The report complained MESBIC funds are only being partially invested, MESBICs are opting for loans rather than the more risky equity participation, and some of the arrangements with the small businesses appear to be one-sided in favor of the 301(d) licensees. The Comptroller General further complained that the Small Business Administration has essentially adopted a hands-off approach to the program.

The conclusion is obvious. The MESBIC industry has not been as effective as many people had originally hoped, retaining sizable "idle funds". However, this field has proven very difficult, and many of the MESBICs that quickly became "fully invested" are now bankrupt or have serious financial problems.

THE DELIVERY SYSTEM

The legislation -- "The Small Business Investment Act" -- could have flourished. There has been some stimulation . . . the amendments providing for MESBIC licensing. However, this legislation now has broader meaning and is even more vital, essential and timely.

Clearly John Q is sitting it out. He's not interested in further manipulation. Almost everyone who has sought to play has lost, trying to outguess the insiders who control the market or betting on guarded averaging (less the monumental fees, of course) called mutual funds.

The New York Stock Markets and all its regional expersions are nothing more nor less than a national legalized lottery.

Americans spend their money, squander it, invest it, use it as they may; however, the profound tragedy is that very few investments made via the traditional stock exchanges, have any impact on the creation of new opportunity, new base wealth, or new jobs.

Our tax laws encourage this speculative exchange in the abused hope such stock purchases will create true working capital for expanding the economy and its requisite expansion of the tax base.

Favorable tax treatment to compensate (thus lower or minimize) risky investment is strong incentive and should be used to encourage the creation of new working capital, but the present concept of "capital gains treatment" simply mitigates a nation-wide swooping of stock purchases with little creative spin-off (except, of course, the brokerage commissions).

Really, however, aren't we now in a critical situation? The major corporations, perhaps seeking greater control for the majority stockholders, have managed to get American Business -- some of our most essential enterprise -- into a heavy (virtually untenable) debt (rather than equity) financing positions.

The lending institutions are now virtually unable to assemble capital for further debt financing because John Q. can't bank it fast enough. So now comes government loans and guarantees of repayment in the name of "job saving". Consequently the present corporate owners have the equity ownership and John Q's tax money.

Truth is -- if we face it -- there is little relationship between the purchase of equity through currently available means and the creation of new opportunities and jobs. Traditional methods if one can surrender twenty to thirty percent of the proceeds of capitalization for new or expanding enterprise have been constricted and in many instances closed.

Regardless of the stock issue or its bearing on the quality of American Life, it has not a chance unless the brokerage houses can get their share off the front.

If well-established, major corporations cannot effectively raise new capital, although willing to sell new issues at low price to earnings ratios and at equal or below book value, then the opportunities and money raising potential for small endeavors in underdeveloped areas is virtually non-existant.

Simply stated -- there is no genuine opportunity for a prospective investor to purchase direct ownership in his neighbor's business.

Yet another way --

I've gotten down to my last pair of shoes,
can't even win a nickle bet,
cause them that's got is them that gets,
and I ain't got nothing yet.

But it doesn't have to be this way! We, the American people, have in the Small Business Investment Act of 1958 a chance to perfect new enterprises and economic opportunity. Isn't that the name of the game? Free enterprise?

The Delivery System

For 20 years, high potential legislation has proposed substantial opportunities to address many "investment capital" deficiencies. Yet, where is the "delivery system"? How can we (1) organize a maximum number of new investors and investment companies, (2) organize and coordinate all possible supportive resources, and (3) organize broad-based equity participation?

EDI recommends new public policies to deliver the full potential of this small business investment concept to the American people.

Our experience indicates resources to organize a select area could be annually provided for $200,000 to $300,000. These resources, whenever necessary, can be supplemented by other philanthropic grants. Such resources could effectively impact a target area as large as a multi-state rural area or one major urban center.

Through retained equity and service fees, capital base "delivery systems" serving specific geographical targets can mostly become self-supporting within 10 to 15 years. Thus, overall public funding costs for new "delivery systems" should stabilize or decline over time.

Costs for an individual delivery system will vary greatly due to the potential for in-kind contributions and part-time staff services. A basic annual budget is itemized below:

Senior Staff (director, liaison staff, as well as legal, fiscal and/or investment personnel)	$100,000 to 140,000
Clerical and Research Staff (1 to 3 people)	10,000 to 30,000

Consultants (legal, technical and developmental)	70,000 to 100,000
Office, Telephone, and Supplies	8,000 to 20,000
Travel and Per Diem	15,000 to 20,000
Fringe Benefits	14,000 to 20,000
TOTAL COSTS	$200,000 to $300,000

When the total program costs and benefits are fully considered, one must conclude that society cannot afford to neglect substantial "capital base" formation.

What other public program offers the opportunity of amassing substantial new private investment monies through a modestly priced and eventually a self-supporting program? What other program offers a proven tax-generating, low-cost employment creating, and essentially a private enterprise approach to community development and reinvestment?

In a society that literally spends billions annually through government bureaucratic structures for social welfare and community development, the time has come, in our opinion, to fully analyze alternative approaches. If we don't act constructively, it could very well mean the stagnation of our economy, the serious economic decline of our central cities, the further erosion of the small business sector, and the possible end of our free market, democratic way of life.

It will remain unlikely that the nation can finance its equity capital needs only through present financial programs. Instead, institutional approaches that pool, leverage, and safeguard broad-based investment activity is the most realistic solution. The model provided by the SBIC industry offers an economically sensible and time-tested way to proceed, particularly if new delivery systems and other incentives improve the legislation.

Senator **Dixon**. I appreciate your contribution very much. I am intrigued by the idea of private individuals participating in the financing opportunities in the zones. That is something to consider.

It has an obvious community appeal for participation by the people that live there. And I would also like to observe that I would like to have from you as a person experienced in the area where you do your work some contribution from you about your thoughts about the zones sizes.

You indicated that you think the concept is too small. I agree with that. I wonder if you could give us the benefit of your expertise where you work. this is at your pleasure, not now. But if you could get it to us, it will be incorporated in the record. I found all that you said to be very valuable, particularly the discussion about the neighborhood participation in the programs. That is a thing of value.

I would appreciate it if you would expand on that, such as, how you perceive that working in the west side of Chicago for example.

Mr. **Patterson**. It would be very valuable and important for neighborhood development to do small business packaging and other services to be very directly included in any zoning management contracts that are drawn up with local communities and eventually the Federal Government. That would be the first thing, offhand.

If I might add one other thought, it may seem somewhat visionary to believe that the participating of small investors within local communities even at $10 a month can make that much difference. But the fact remains that if you are able to structure profitable investment mechanisms through the use of guaranties and community development block grant funds, that would enhance any private return to any private small investors, if you could do that first.

Then our opinion is that there are 7 million people in the Chicago metropolitan area. If everyone is putting in $10 a year, that is $70 million a year worth of potential small business investment accumulated. If we go to $10 a month, it is 12 times as much as that.

And the fact remains that if we are really going to redevelop these inner cities and these areas and not just create a handful of new businesses and jobs and a marginal level of impact, what we need to do is create a truly substantial number of new businesses and jobs and creating that kind of new investment, properly managed, could have a very, very substantial impact.

Senator **Dixon**. Well, I think it is a dynamite idea. We will give that a lot of thought. Thank you.

Mr. Mullins, you are last but certainly not least. Mr. John Mullins of the DeKalb Economic Development Commission. I think it worth mentioning John, that when we talk about this entire concept, we don't just talk about Chicago. We talk about DeKalb and Kankakee, Rockford, Rock Island.

We thank you for taking time out of your busy schedule to come here from DeKalb and to make your contribution from the perception of the smaller community interested in these smaller problems.

STATEMENT OF JOHN M. MULLINS, ADMINISTRATOR, CITY OF DeKALB ECONOMIC DEVELOPMENT COMMISSION, DeKALB, ILL.

Mr. **Mullins**. You have given me an advantage here, all the technical and financial resources and vast knowledge. I am overwhelmed by some of the suggestions on the panels.

We have had some discussion in our community about small investor contributions toward resources for small businesses. I think there is a lot of enthusiasm for the local people for that type of effort.

Senator **Dixon**. I just want to say that I know you will do your best. I have stolen from you the best mayor DeKalb ever had. She sits to my immediate right over here. But taking into account that her great leadership is lost to you, I know you will do your best.

Mr. **Mullins**. The concept from the perspective, the local rural economic perspective, I think some of the most important things to realize is that the concept of enterprise zones needs to have more in it than what we have read in terms of the bills. And I have appreciated most of the comments we have heard today. They were so much more involved in terms of specific communities than simply tax incentives or freeing up regulations.

Over the past 10 years, the process of decisionmaking on the part of small businesses as well as large businesses has basically fallen into two categories: the cost items and the noncost items. And essentially, to summarize quickly, in the cost items for businesses, when they are making a decision to move into a community, it is primarily in the area of buildings, land, taxes, the cost of transportation in terms of gas and services, the cost of labor in the community, and the cost of utilities which are the primary factors to the cost of doing business in a community.

Now all those relate to, and we have heard comments here earlier today, the need for capital for a small business. If you don't have capital, you are not even going to be able to get involved in the cost items.

So my comments basically assume there would be some kind of capital available and that that needs to be done.

The idea of pooling industrial revenue bonds in terms of small investors, small borrowers is an important concept in a rural community.

In the area of cost items, for the past 10 years those items have created the major differentiation that we see between the north and south and east and west in terms of regions. We hear about that movement to the Sun Belt being talked about as being very important. The reason for that is that many of those cost items, there have been major differences for a business in building and lands and in taxes, in transportation, in labor and utilities.

However, those things are equalizing. The cost of doing business in the south and southwest is going to be within the next few years equal to doing business in the midwest, the industrialized northeast. So those items are going to be less important to economic development in the future.

The items that are going to be important, assuming you have capital and we need not go into that any further, but the items that will be important to a business in terms of determining factors will be the availability of skilled labor, the human resources in a community, the availability of a strong educational system because most of the workers in rural communities come from the educational system within that community, the ability of a community to provide services to business.

And I know it is popular to believe that government and industry work at opposite ends, but they don't in rural communities. They have to work close together in order for both to grow and prosper. And the feeling in our community has always been in recent times of a strong commitment on both parts. They need to address the problems of deteriorating road conditions and deteriorating educational systems, the lack of power, utilities, a poorly managed fire department or police department which becomes very important to a small business, and the attitude of the community itself.

Other noncost items that become very important to a business when looking between one community and another are the incentives the community offers such as the availability of UDAG funds, IRB's. These are important as well as public improvements that can be done under those programs.

Much of the concern that we have in rural communities are listed in my prepared text, Senator. We have done some research in our community which is a rural community. Our labor force is estimated at 36,000 individuals. What we have found is that over the last 10 years, we have had a substantial reduction in jobs in the goods producing industries in our community and an increasing dependency on the public sector for employment. That is something that is creating a negative environment in our community and it is a tremendous danger signal for the next years.

One of the most startling figures in our community is in the area of skilled employees, skilled machine operators, skilled craftsmen. In our community, there has been a reduction from 17.1 percent of total community down to 12.9 percent in less than 10 years.

A survey that we have just completed and will be released within the next 3 weeks shows that the average man in many of these skilled job categories is approaching 60 years of age. Now what that says to a business in our community is that within the next 10 years, if you are relying on skilled employees, that those employees are going to be retiring from the work force.

In a rural community it is difficult to attract people to move into those areas in some cases because the jobs aren't there. The price of labor or cost of labor isn't high enough to support a move into the community or support a family in that community. And as a result, we are losing those jobs. Business is simply attritioning those jobs away. If you look at our community, you won't see very many boarded up factories, but you will find that factories are operating at much lower levels of employment. And many of those levels are in the areas of skilled labor and skilled employees.

Our school system, we are looking at our school system. And when we track many of our young people in our community, we find that 3 out of 4 local high school graduates are leaving the community. And after 5 years, they don't exist within the community in any way, shape or form. The reason for this is essentially a declining industrial base, an increasing dependency on public sector jobs with low turnover.

The direction of focusing any effort on small businesses is very important to a rural community. In our area, we have over 1,000 established employers. And yet all but about six are small businesses. Any emphasis in the small business area will certainly have a positive effect.

The ability of a community to retain and expand current businesses is so important because the revitalization will come from existing businesses. We need some sort of incentive program which will allow these businesses to do that.

Disadvantaged workers are simply not going to find jobs if there isn't an expanding job base in the community. And one of the primary problems in the rural areas as well as your urban areas is the deficits in vocational training programs. We have had a problem with training people on antiquated equipment and methodology. And a major problem with some of the CETA programs and public service programs is that the bureaucratic structure has prevented some creative program from being developed which would try to answer some of these problems in the vocational training area.

One of the concerns in the Smith-Hughes Act [sic] is that much funding for vocational programs have the school system tied to the local level. This argues against them being able to invest in new equipment and new training techniques.

The concept of privatization in our community has really had an opportunity to be tested. And under our former mayor, to which reference has already been made, we have taken two small departments of our city government and essentially reorganized those services and purchased them from private vendors.

Over the last 3 years—this will be our fourth year going into it—it is estimated that the community alone has saved $250,000 from two very small departments within our local government.

The involvement of many neighborhood groups is helping this effort with people volunteering in the community and getting involved in small organizations.

In summary, the concern in terms of a rural area primarily is, it is a cycle. If you lose jobs, if business simply attritions off job positions in the community—in other words, when somebody retires, instead of filling it, they leave that position to drop—it is going to have an effect in terms of loss of skilled labor in the community and people will simply leave a community in order to find work.

The second issue is the essential one of need for a strong educational system and a continuation of strong education because in a rural community, that is where our labor force comes from. We don't have the luxury of having big ticket employers who can pay the bill of $12 and $13 an hour. That is not the way the small business operates in rural communities.

In summary, we realize that enterprise zones will primarily be situated in urban areas. But we would like to think that some of the concepts that were shared here by all the people that have testified here today might have application in rural communities.

Thank you.

[The prepared statement of Mr. Mullins follows:]

Economic Development
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DeKalb

Statement by
John M. Mullins
Administrator, City of DeKalb Economic Development Commission
200 South Fourth Street
DeKalb, Illinois 60115 (815-756-4881 Ext. 311)
Before Subcommittee on Enterprise Zones
Small Business Committee
April 7, 1982

Mr. Chairman, I want to express my appreciation for the opportunity to present testimony at this hearing on "Enterprise Zones". I would like to direct my comments to the effect of "Enterprise Zones" on rural areas. Since I have worked with Economic Development activities in the DeKalb Community for nearly three years, I will use DeKalb as an example of the potential impact of this proposed legislation. DeKalb is predominately a rural community located in northeastern Illinois and is approximately 1.5 hours driving time from Chicago. With a County population of 75,000, our total civilian labor force is estimated at 36,000. The unemployment rate for our area is nearly 9 percent. H.U.D. has determined DeKalb to be U.D.A.G. eligible for the past few years.

Most economists look at this recession as starting 9 or 10 months ago. However, in our Community, the contraction in employment began in the Summer of 1980 and continues to the present. Many workers that were laid off as a result of rising interests rates and falling demand for the products in that summer have never been hired back. Most of these workers have had to leave the area in order to find work. Rural areas such as ours face several unique problems.

Over the last decade, the number of jobs available in goods producing industry have declined by over 13 percent. If not for the addition of one medium size employer in 1977, we would have lost over a quarter of these jobs in less than a decade. The number of skilled machine operators and craftworkers had declined from 17.1 percent of total jobs in 1970, to 12.9 percent in 1980.

A recent study shows that in our area the average age of skilled operators is nearly sixty. Most of these skilled employees will reach retirement age during the next decade. During this period, employers will face the alternatives of dropping parts of their production line, or leaving the area to find the skilled help needed for that industry.

At present, nearly 3 out of 5 of our local high school graduating class have left the area after five years and do not return. The reason for this is a combination of a declining industrial base and an increasing dependency on Public Sector Employment that has little turnover.

Enterprise Zones would have several important impacts on the DeKalb Community;

1.) Retention and Expansion, of existing business is critical to the development of new jobs in the next decade. Research indicates over 75 percent of the new jobs created come from existing business.

2.) Small Business, in DeKalb of the 1,000 established employers all but 6 can be classified as small business. Any emphasis on small business would aid the largest groups of employers. It is the small business that has the most difficulty in handling federal tax burdens and regulations.

3.) Revitalization, our Community faces the possibility of increasing dependency on Public Sector Employment. Over the next decade DeKalb will lose a significant share of its private sector jobs. This program would help to stabilize and revitalize private sector employment.

4.) Disadvantage Workers, without an expanding private sector there will be an ongoing lack of opportunity in this area for all workers.

5.) Privatization, over the past decade local government employment increased significantly. There has been serious discussion of contracting out services in our Community. Two successful pilot efforts were initiated by our former Mayor and Council. Two small departments were re-organized and services were purchased from private vendors. Savings from these two small departments have totaled over $250,000 in three years.

I want to thank you for the opportunity of briefly sharing these ideas with you and your committee. If I can be of further assistance to you, please contact me at your convenience.

Senator DIXON. I thank you very much for that excellent contribution. We appreciate that very much because it is relative here and valuable for this record.

We thank you all for coming here today and for your valuable comments and contributions. The record remains open for the contribution of other statements, that may be sent to us from either those who have spoken here today or others who may wish to contribute their points of view.

Again, thank you for participating. I appreciate it.

With that, we will adjourn.

[Whereupon the hearing adjourned.]

[Additional information follows:]

ENTERPRISE ZONE PROGRAM

By Congressman Paul Findley

I am glad to be a cosponsor of the enterprise zone program.

Establishing urban enterprise zones and economic incentives to bring development and jobs to the most depressed sections of our nation's cities is long overdue. The problems facing many of our once thriving cities and those residents who have remained behind after the exodus of business from those areas is serious indeed. Decatur, Quincy and Springfield, which I represent, are communities that certainly merit this special assistance and they would indeed qualify under present criteria.

I am also pleased that similar incentives will be available to depressed rural areas of our country. Originally the focus was almost entirely upon urban enterprise zones, despite the fact that unemployment in some rural areas is just as severe as it is in Detroit or Chicago. A family whose breadwinner is without a job is just as bad off in Calhoun County, Illinois as in Cook County.

In Montgomery County, Illinois, for example, unemployment is at 11.3 percent; in Shelby it is 11 percent; in Jersey, 12 percent and in Calhoun, 12.3 percent. A family without regular income in one of these areas has the same trouble keeping body and soul together as a family in a city. And the impact on the local economy of high unemployment is just as severe even if it is somewhat hidden among the rolling Illinois countryside.

It is important to put the maximum number of people to work, no matter where they live. And it would take far fewer incentives to bring industry to America's small towns, so that a given amount of money might actually go a lot farther and possibly result in the creation of more jobs in rural areas.

Again, I am proud to be a cosponsor of this initiative. Although the problems of urban areas and rural towns cannot be solved overnight, I view this initiative as one of great promise that can help to revitalize these areas and restore their vitality, making them both socially and economically desirable places to live.

STATEMENT OF ILLINOIS MANUFACTURERS' ASSOCIATION
REGARDING LEGISLATION TO CREATE ENTERPRISE ZONES

Senate Small Business Committee
Chicago, Illinois
April 7, 1982

Problems with the Enterprise Zone Concept

Enterprise Zone legislation, being considered at the federal and state level, is designed to provide help to selected economically eroded areas in some cities.

While the idea of Enterprise Zones is fascinating and, considering the seriousness of inner-city economic problems, deserving of a try, there are serious questions regarding the feasibility and fairness of such zones.

The drawing of boundaries delineating Enterprise Zones will probably prompt a raging debate, being challenged by those businesses and communities that will not enjoy the incentives available in the zone. There will also be strong complaints from municipalities and areas at not being included. The arbitrary act of excluding businesses just outside the boundary (regardless of where the boundary is drawn) will put the outsider manufacturer at a cost-competitive disadvantage with his in-zone competitor. This presents a real problem of fairness. This disadvantage could prompt a serious court challenge to the constitutionality of the Enterprise Zone idea, based upon the U. S. Constitution provision guaranteeing equal protection of the laws.

As to the problems of the inner city and incentives to employers to provide jobs there, there are several conditions at present that need rectifying and have nothing to do with Enterprise Zones. Rather, they have to do with the political, social and economic policies and practices that have evolved in our society.

(1) Too many prospective workers are inadequately educated. Employers will try to avoid hiring the applicant who cannot read or write English. The needed greater emphasis on education is even more important because of the trend toward increasing technology and complexity in products and processes.

(2) Availability of a variety of welfare benefits over a long period of time has eroded the will to work of many people. The entire system of welfare benefits should be reexamined. Government grants, subsidies, and make-work, unproductive projects have not provided any permanent relief to the problems plaguing troubled inner-city areas. Therefore, the main thrust of Enterprise Zone legislation, to provide productive, meaningful jobs through the private sector, is certainly correct and welcome.

If the Enterprise Zone idea is successful, then Enterprise Zones should be expanded to include the entire U. S. A vigorous private enterprise system, freed of many of the present tax and regulatory impediments to growth, would help solve many of the great national economic problems.

Suggestions Regarding any Enterprise Zone Legislation

Despite these problems and doubts regarding the Enterprise Zone idea, if there is to be Enterprise Zone legislation, the following observations and recommendations are applicable:

(1) The original philosophy in creation of Enterprise Zones was to let private enterprise flourish in an area made essentially devoid of the debilitating impact of governmental regulation. To the extent possible, this should be followed in any Enterprise Zones created by state and federal legislation.

(2) Because the regulatory and tax impact of the federal government upon manufacturing firms is considerably greater than that of state government, it is important that there be federal as well as state and local participation in incentives for a zone, and that every effort be made to coordinate the programs. In fact, it would be logical for states to tailor their Enterprise Zone legislation to that of the federal government.

(3) Using Chicago as an example, the serious economic problems of many of its neighborhoods have resulted in large part because of the substantial loss of manufacturing jobs. Between 1973 and 1978, there was a net disappearance of 658 manufacturing firms from Chicago, more than 9 percent of its total. With the resulting increased unemployment and economic malaise, employment in retailing and service establishments was also hard hit. Therefore, labor-intensive industries should be a prime target of any enterprise zone bill.

(4) The fundamental purpose of such legislation should be to provide jobs for inner city residents; productive and permanent jobs, not make-work jobs. When people are meaningfully employed, many of the present curses of high unemployment will disappear, and urban renewal will tend to follow.

(5) It will take substantial and meaningful incentives to encourage new industries to locate in the inner cities. A 1979 survey of Chicago manufacturing firms as to why industry was leaving revealed many reasons, several of which were peculiar to the inner city: quality and productivity of the labor force; crime and vandalism problems; and obsolete plants and lack of room to expand. High real property tax rates and the Chicago head tax were also mentioned strongly.

(6) Tax incentives provided for Enterprise Zone businesses should, to the extent possible, reward the employer for creating new jobs. This would apply to existing businesses as well as new plants and businesses. This should be the major thrust of tax incentives for the zone. However, reduced real property taxes will provide incentives for existing businesses to stay as well as for new ones to move in. There should also be a strong prohibition against any "per employee" tax on employees in the zone, such as Chicago's head tax.

(7) The capital requirement problem of new or expanded business facilities in the zone should be addressed in Enterprise Zone legislation. This could take the form of loan guarantees, low interest loans, industrial development bonds, or other means of assistance. To the extent possible, the amount and kind of financing assistance should be geared to the number of new jobs created rather than the size of the capital investment.

(8) Local zoning rules tending to inhibit desired economic growth and development in the zones should be preempted where necessary. Similarly, eminent domain powers should be able to be used to condemn property for the higher priority economic use. Industrial parks should be encouraged where feasible. Extra police protection should be provided where appropriate.

(9) Zones should be established in any city in Illinois meeting the minimum eligibility criteria. Zones should be as small as economic and geographic conditions permit. Zones should have a limited life as such, since a permanent advantage for such locations have to be based upon a defeatist conclusion that the zones will never catch up and the program would be a failure.

Small Business Interests and Needs

Small manufacturing firms are logical targets for Enterprise Zone incentives, and would be particularly beneficial to those zones in providing productive jobs and good employer-employee relationships. Probably the smaller company's greatest need, and the factor that would provide the greatest incentive to locate or expand in the zone is that of availability of needed capital at an affordable cost. The industrial revenue bond might be made particularly attractive for such firms expanding or locating in the zones. The small company could also well use help in providing needed training for new employees.

OVB:df

community renewal society

Renewing the metropolis through faith in action

March 31, 1982

Hon. Alan J. Dixon
230 S. Dearborn, Room 3996
Chicago, Illinois 60604

Dear Senator Dixon:

Thank you very much for your invitation to submit written testimony to the Senate Small Business Committee hearing on enterprise zones scheduled for April 7.

Community Renewal Society has been interested in this issue on the basis of its historical and lively collaboration with communities of the sort which seem intended by the currently proposed legislation. Provisions for small and expanding business are crucial because that is where new jobs are, and because community development corporations will be turning increasingly to enterprises of their own.

In a CRS-sponsored consultation held February 22, representatives of larger firms made it very clear that they are not now in the business of creating new jobs. Smaller businesses expressed a primary need for capital and for affordable utility costs, which are not included in present bills.

Experienced leaders of community based organizations engaged in economic development of their areas have subsequently hammered out an advocacy with respect to enterprise zone concept and proposals. Board of the Community Renewal Society has formally agreed with the statement for use with legislators.

I will attach a copy of that statement for review by your committee.

Respectfully,

Richard H. Luecke, Director of Studies

APR 7 1982

111 North Wabash Avenue, Chicago, Illinois 60602 Phone: (312) 236-4830

We of the Community Renewal Society and collaborating community organizations have reviewed federal and state proposals for the establishment of enterprise zones. Our communities in whole or part are such as could be designated enterprise zones. We have engaged in an extended consultation with sponsoring federal and state legislators, with city commissioners, and with leaders of large and small business as well as of technical assistance groups for small and minority enterprises.

We now write urging you to set aside efforts to improve legislation of this sort and to give consideration to a more appropriate policy for economic revitalization of our communities.

On the basis of our years of experience in community economic development, we recognize the need for reinvestment and establishment or expansion of job creating firms in our areas. However, we find the enterprise zone concept expressed in various draft legislative proposals unsound in principle, uncreative, and counterproductive for community revitalization. We do so for the following reasons, among others.

1. The enterprise zone concept and provisions will serve to drain those needy areas in our city which are not designated in favor of those which gain zone status, thereby setting back efforts for revitalization in more communities than are helped.
2. There is no reasonable assurance that labor intensive activity will be attracted to the zones.
3. Tax incentives, while costly to the public, are of highly questionable effectiveness in attracting business, for which other incentives are known to be more important, such as a trained work force, transportation, infrastructure, and affordable energy costs. Abatement of capital gains tax can scarcely be used at all by emergent firms in our areas.
4. The enterprise zone concept makes inadequate provision for availability of capital which is the primary need of new and expanding small business.
5. The concept does not address the need for rehabilitation of deteriorated infrastructure.
6. The concept affords no assurance that, when tax advantages expire or wages rise, businesses which have been attracted to the zone will remain.

7. The enterprize zone concept is too limited in scope to facilitate the community climate and cooperation which are indispensable in achieving investment and wholesome development.

While some of the above deficiencies may be removed in legislation using the enterprise zone concept, it appears that others cannot. Thus the enterprise zone concept fails to take into account established principles which must be observed if sound and successful economic development is to be achieved. We believe that any public policy and program for urban development must reflect the following understandings.

1. Publicly afforded benefits should be made available without discrimination in all communities suffering high levels of unemployment and disinvestment.

2. No urban economic development program can succeed without the cooperation and resources of government at federal, state and local levels: e.g., in addressing needs for education and training, for infrastructure, and in creating incentives for supply of capital.

3. No urban economic development program can succeed without participation by various groups in the private sector: finance, manufacturing, business, services, and voluntary associations.

4. No urban economic development program can succeed in Chicago's neighborhoods without governmental and private sector cooperation with respect to housing stock and reasonable access to housing.

5. No economic development program can succeed without striving for work conditions and a wage structure which support an adequate quality of life.

6. Most important: no urban economic development program can succeed without establishing a significant role for community leadership in planning and administration, and without participation by the community itself as an equity partner and as an employment beneficiary.

We strongly recommend that present attempts to prepare and submit enterprise zone legislation be dropped and that, instead, attention be given to the development of policy and programs implementing the economic principles set forth immediately above.

We will continue our creative approaches to the economic development of our communities and will be giving sustained attention to formation of appropriate public policy and programs. We offer our cooperation in that considerable endeavor.

ELGIN
COMMUNITY
COLLEGE

Community College District 509 1700 Spartan Drive, Elgin, Illinois 60120 Phone: (312) 697-1000

April 6, 1982

Senator Alan Dixon
Senate Hearing on Enterprise Zones
Chicago, Illinois

Dear Senator Dixon:

Thank you for the opportunity to have some input about Enterprise Zones before they are constituted in law.

The concept of assisting communities to attract and retain industries and more particularly small and medium-size businesses is vital to the stability and growth of mid-western communities. However, the guidelines I have seen published (in *Nation's Cities Weekly*) specify that a community must be UDAG certifiable. Not one of the 19 municipalities ranging from Elgin to Wasco in our college district qualify.

It seems to me in a triage situation with federal funds, that dollars should be put where they will do the most good. A community like Elgin has great need to attract businesses. To that end, the municipality, the Chamber of Commerce, two special downtown organizations, and Elgin Community College have cooperated in joint ventures of many different kinds. Would not federal enterprise funding be better spent and go further where there is a bona fide local effort currently in progress?

Tying every dollar of federal funds to UDAG guidelines effectively eliminates all but a few very large cities. Perhaps several levels of zones could be established without UDAG's stringent guidelines--for small rural communities, mid-size cities and large metropolises.

That way, local efforts to attract and maintain a vital business community would be rewarded, the federal dollars would stretch further, and mid-western (Illinois) towns would have help in retaining a strong economic climate.

Thank you for your consideration of these ideas.

Sincerely,

Sue Moylan

Sue Moylan
Coordinator, Local Government Training

Planning Commissioner, City of Elgin

ILLINOIS-INDIANA
BI-STATE
COMMISSION

One East Wacker Drive · Suite 3630
Chicago, Illinois 60601 · (312)467-4612

WILLIAM L. STAEHLE
ADMINISTRATOR

April 7, 1982

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City of Gary

W. Atterson Spann, Jr.
Commissioner, Lake County

ALTERNATES:

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Councilman, Porter County

Robert Farag, Director
Div. of Physical & Econ. Dev.
City of Gary

Mayor Robert A. Pastrick
City of East Chicago

Mayor Edward J. Raskosky
City of Hammond

Joy Rothrock
Administrative Assistant
Office of Governor

TESTIMONY ON ENTERPRISE ZONE LEGISLATION

Submitted to the Senate Small Business Committee

The Illinois-Indiana Bi-State Commission is pleased to provide testimony on Enterprise Zones to the Senate Small Business Committee. Since our creation in 1974, the Commission, comprised of 6 Illinois and 6 Indiana members representing city and county government, has maintained a vital interest in regional economic development issues. Our area of jurisdiction is the six counties of northeast Illinois in the Chicago metropolitan area and the three counties of northwest Indiana bordering Lake Michigan. In 1978, we sponsored a regional conference on the future of economic development in metropolitan Chicago and most recently we have prepared a comprehensive report entitled Industrial Revenue Bonds: Regional and National Issues for Economic Development and Public Policy. This report as well as our participation in Governor Thompson's Task Force on Enterprise Zones provides us with an informed perspective from which to speak on the enterprise zone program.

The concept of enterprise zones as it is outlined in statements from the Reagan Administration, emphasizes the creation of a free market environment in officially designated locations. This environment, accomplished through federal tax incentives and regulatory abatements, aims to encourage the growth of new businesses and to retain and expand existing businesses. It also requires a large dose of state and local government commitment and input.

To achieve measurable and significant results in the effort to stimulate the economies of distressed areas, the enterprise zone programs must focus on the realities of small business creation and operation. It has been widely noted that many types of tax incentives have slight impact on small businesses which show little or no profit. It is also well known that small businesses are major employers of the unskilled and semi-skilled labor force prevalent in distressed areas. These two considerations serve to highlight the need for a vehicle other than tax relief to protect and strengthen small business operation.

From our regional investigation of industrial revenue bonds (IRBs), the Bi-State Commission concludes that small businesses receive substantial benefits through the use of this financing tool. Our report specifically recommends the continued use of IRBs for any small business in a distressed area. It also calls for public hearings on each bond application and public reporting for all bond closings. The monitoring of job creation and retention for each IRB issued should be an additional component of the program. Each of these recommendations is consistent with enterprise zone theory and supportive of sound mechanisms to measure program impact.

In the metropolitan Chicago-Gary region, the use of IRBs has received near unanimous praise from local government Economic Development Commissions and participating industries alike. The retention of industry and the creation of new jobs through business expansion are the most oft-cited benefits of the program. Small businesses are especially enthusiastic about IRBs because they offer below market rate interest on loans to permit investments impossible at commercial rates.

The criticisms of the IRB program at the regional and national levels can be largely eliminated when the bonds are used in conjunction with enterprise zones. Briefly, these criticisms include the widespread use of tax-exempt financing for commercial projects in strong, expanding market areas; the lack of public scrutiny due to incomplete bond reporting and information on employment impact; relocation away from distressed areas with the help of IRBs; and the use of numerous IRBs in various locations by a single large national corporation. The enterprise zone offers a good opportunity for local governments to exercise stricter controls over bonds let and provides the federal government with a manageable test of the bonds' effectiveness in meeting economic development goals within clear-cut parameters of public interest.

One widely debated criticism of the IRB program is the effect that tax-exempt bonds have upon local bond markets. Some authorities feel the bonds compete adversely with local government's own general obligation bonding requirements. Recent higher volumes of IRBs have increased this concern. In this case as well, if the use of IRBs is subject to increased public scrutiny in enterprise zones, widespread use of the bonds locally and nationally will be curtailed.

In comparison to the enterprise zone purpose of expanding opportunities for the unemployed, the IRB program in this nine county region has already created employment in distressed areas. The Bi-State Commission's study found that although job reporting in some areas of the Illinois region is incomplete and little effort has been demonstrated to conduct follow-up evaluations of actual jobs created, among the industries reporting employment data there is a significant employment impact. This evidence underscores the importance of including IRBs in the enterprise zone program so as to take advantage of their proven benefits and to fully evaluate their effect on employment creation and retention.

The citizen participation component of the enterprise zone is an essential and important feature of this program. Its relevance to small business financing through IRBs is in the monitoring and evaluation of employment impact. The experience in this region--and especially in Chicago--shows that local residents have a growing concern for the accountability of businesses that are favored with tax-exempt financing. Citizen groups have stated that if the creation of jobs is specified in an IRB application, local people should have an opportunity to apply and compete for the positions. The enterprise zones neighborhood organization in concert with local public officials can go a long way towards improving public scrutiny of the IRB program.

In summary, IRBs serve a number of important purposes for small businesses. They provide a source of financing in cases where other markets are not affordable. They have received widespread endorsement from businessmen and Economic Development Commissions for their relative lack of red tape and efficient completion schedules. IRBS have an established track record and have proven to be an effective private market - public authority partnership to benefit small businesses. And, although records are incomplete in this region, it is clear that IRBs have created significant employment expansion and retention for small businesses. All of these features are compatible with and will increase the effectiveness of the enterprise zone adventure.

This brief discussion of the strengths and weaknesses of the IRB program attempts to emphasize the importance of this financing tool to small businesses and to the enterprise zone program. Although the Bi-State Commission has recommended that some restrictions on IRBs are desirable to best serve the public interest and national policy goals, we strongly recommend the maintenance of this program for the benefit of small businesses in enterprise zones.

STATEMENT OF
DR. WALTER E. MASSEY
DIRECTOR, ARGONNE NATIONAL LABORATORY
AND PROFESSOR OF PHYSICS, UNIVERSITY OF CHICAGO
BEFORE THE
SMALL BUSINESS COMMITTEE
UNITED STATES SENATE
APRIL 7, 1982

Mr. Chairman, Members of the Committee:

I am pleased to be invited to provide testimony for this hearing of your committee. To put the following testimony in perspective, it is appropriate that I comment on my background and recent experience. I have been a researcher, educator and administrator primarily within the academic community. For the past three years I have been Director of Argonne National Laboratory. Thus my experience is of one involved in education, research and development in the university and national laboratory environment.

For the past seven months I have chaired a Task Force on High Technology Development appointed by the Mayor of Chicago, Jane M. Byrne. The Task Force is composed of representatives from local universities, industrial firms, financial institutions, real estate firms and local government. A significant fraction of the members have considerable experience in research and development.

The Task Force has found that the Chicago area has a tremendous resource in its established universities and industries. Several different types of research laboratories offer an additional strength to the area. Illinois ranks seventh among the states in total number of industrial research laboratories, including large institutions such as Bell Laboratories, Amoco Oil's Research and Development Laboratory, and Motorola, as well as smaller institutions. Almost 40% of the state's industrial research laboratories are located in the City of Chicago, and more than half are located in the Greater Chicago area, including Des Plaines, Northbrook, Rolling Meadows and Naperville. Large, multipurpose, independent research institutes in the area include IIT Research Institute and the Institute of Gas Technology. Both have been in existence forty or more years. Other not-for-profit research institutes, such as the Association of American Railroads' Technical Center and the Portland Cement Association's Construction Technology Laboratories, are smaller and more focused in nature. The federally supported laboratories--Fermi National Accelerator Laboratory and Argonne National Laboratory--in combination with these other types of institutions, furnish the area with a varied and diverse research and development base.

It was the recognition of this resource and the potential for economic development, in particular job growth through entrepreneurial activity, that resulted in the formation of task forces by both Mayor Byrne and the Governor of Illinois, James Thompson. These task forces have worked together closely. I have participated in meetings of the Governor's Task Force and reports of the activities of each have been shared with the other. Also, several firms and institutions have provided members to both groups.

The Governor's Task Force has looked at specific, focused opportunities for increasing research and development activities in Illinois. The Mayor's Task Force has looked at the longer range issue of the contribution to economic development and job generation that high technology can bring to Chicago and the metropolitan area. This Task Force issued an interim report on March 16, 1982 (copy attached) and plans to submit a final report in the fall of 1982. The Governor's Task Force also recently submitted its report.

Senator Dixon's letter of invitation placed particular emphasis on how the interests of small business can be best protected in the enterprise zone program. It is clear that the growth of small businesses provides for the largest fraction of job generation in the United States. This conclusion stems from studies, such as those of David Birch of MIT, of how firms grow, and their movement and employment patterns. I believe the main source of these high growth-potential small businesses stems from so-called high technology ventures. Our Task Force has defined "high technology" to mean business ventures that depend for their initiation and continued health on high levels of research and development. "Technology-intensive" is perhaps a more descriptive term. The fact that my belief is shared by others is shown by the many popular articles on high technology and its success in stimulating businesses throughout the nation today.

The interim report of the Mayor's Task Force recommends that the City follow the development of the proposed urban enterprise zone legislation to ensure that technology-intensive firms are given a high priority in resultant activities. The report further emphasizes the need to "grow our own" firms through efforts to encourage new entrepreneurial small business ventures. Attraction programs are necessary but not sufficient.

At this interim stage of the Task Force efforts, specific recommendations relative to entreprise zones have not been fully identified and developed. However there are four significant concerns that have been raised in examining the Administration's proposal. These are particularly important to technology-intensive small business enterprises. They are: (1) accessibility of research and development sources, i.e., easy access to the people involved in university, industry, private or government research and development facilities; (2) availability of a highly-skilled labor force; (3) upgrading of job skills of those within the designated zones; (4) level of services such as transportation and especially fire and police protection that provide a secure working environment.

It is not clear that the proposed designation process brings all of these factors into appropriate consideration.

Firms within the zone should have access to the part time help of graduate students. A number of success stories examined by our Task Force have pointed to this single factor as a key element. Involvement of research scientists and engineers in a variety of roles is important. Thus the distance between the site of such an enterprise zone and research and development institutions should be reasonable. However, it is not necessary that a zone initially contain an institution.

To attract small technology-intensive firms to enterprise zones, a highly-skilled labor force is necessary. While the enterprise zone concept might eventually provide an environment attractive to such a labor force, this would not be the case initially. Again what will be important will be the proximity and especially the accessibility (freeways, tollways, and commuter services) of this labor force to the zone. City services such as fire and police, as well as transportation, will be important. Enterprise zones stressing technology-intensive activities can be an effective method of upgrading the skills of local citizens through job training programs. The largest tax incentive in the Administration's proposal will go to the employers who hire welfare-level members of the labor force. It is clear that the proposal is designed around the concept of attracting existing firms capable of implementing job training programs. New small venture firms are unlikely to implement such programs, instead such programs to give and upgrade skills to the displaced, disadvantaged and unskilled will need to be in place to attract new business starts. It is not clear how the community within designated zones can get all sectors working together to forward finance and establish the needed job skills programs.

Our Task Force has found that the Chicago area has a large technically-trained labor force, and universities, colleges, and other academic and technical institutions are a continuing source of new talent and updating of existing skills. However, we also note in our report: "at the technician level, area industries and universities could make a further contribution to this labor pool by aiding in training Chicago's youth for future technical employment; private sector financing of some portion of the Board of Education's job skills programs should be considered." The enterprise zone concept could be a vehicle to stimulate such cooperative activities.

Unfortunately at this stage of the Task Force's efforts we have only raised questions and not furnished answers. However I hope the sharing of these issues provides some measure of usefulness to the Committee.

INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

FRIDAY, MAY 7, 1982

U.S. Senate,
Committee on Small Business,
St. Paul, Minn.

The committee met at 10 a.m., at the State capitol, room 15, St. Paul, Minn., Hon. Rudy Boschwitz, acting chairman, presiding.

Present: Senator Boschwitz.

Also present: Robert M. Wilson, counsel, and Lillian Saunders, Office of Senator Boschwitz.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator Boschwitz. This morning is the fourth of a series of hearings that have been conducted by the Small Business Committee with respect to the enterprise zone legislation I introduced in the Senate a couple years ago, and again this year with Senator Chafee. We have held hearings not only in the Small Business Committee, but also in the Finance Committee, and it looks like it has a pretty good shot of getting through the Senate this year and also the House. It was introduced simultaneously in the House by Jack Kemp and Bob Garcia. Garcia is the Democratic Congressman from the East Bronx, so enterprise zones have bipartisan support in both Houses and is high on the agenda of the Finance Committee, which in reality handles the legislation, though the hearings are held jointly by both the Small Business Committee as well as the Finance Committee. The Agriculture Committee, incidentally, has also shown some interest in the bill because its rural development committee and this bill applies not only to cities but to rural areas as well.

The purpose of this bill is to bring private business into some of the more distressed areas of the country. We don't represent this bill as solving the high unemployment—the chronic unemployment those areas have had for a long time. Even though unemployment figures are going up overall, the unemployment figures in those areas have been two, three, even four times the unemployment figures in the country as a whole. It's our purpose to bring jobs to those areas.

Yesterday I had in my office in Washington a group of people from Bagley, Minn. In Clearwater County the unemployment rate is 24 percent, which is nearly as bad as even the depths of the inner city. So that this bill is not by any means confined to the

East Bronx where Bob Garcia comes from or to Minneapolis, or Duluth, or some other larger metropolitan area. It's, indeed, directed at all of our country. However, we have restricted the number of enterprise zones to between 10 and 25 a year. Some feel that we should create a very large number of enterprise zones. I have not—I've opposed that feeling, very frankly, because in order to be meaningful, I think that there has to be a very intense bidding process. The Federal Government, through Housing and Urban Development [HUD], is going to grant these enterprise zone designations, and unless we get a real competitive bidding between the communities or counties, we are not going to have successful enterprise zones.

Enterprise zones, incidentally, don't have to encompass a city. You can draw the lines pretty much as you wish. It can encompass a whole city if that's the way the planners choose to do it. It can encompass a neighborhood and it doesn't have to be a neighborhood that's normally thought of as a neighborhood. It simply must be contiguous. A little piece of it can't be here and another piece there. You have to draw some kind of lines. They needn't be straight. They needn't show any type of normal geographic boundary, but they must include so-called UDAG eligible areas, areas where there is high unemployment, where there is a low median income, and areas where new jobs are critically needed—that critical need that exists actually at this moment in the economy as a whole.

It's a good concept. It's not going to solve the unemployment problems of the country, as I mentioned, but it's going to be a step in the right direction, particularly, in areas where there has been festering, continuing, and unremitting unemployment. I think that we're on the right track.

The Federal Government gives a certain number of advantages for businesses that locate in these areas. I'm sure that they will come out during the course of the hearing, so I won't go through the litany of tax incentives that will be available in those areas.

However, even more important than what the Federal Government can do is what the State and local governments can do, because in new businesses, in my experience, the taxes paid to State and local government certainly exceed taxes paid to the Federal Government. In order to pay taxes to the Federal Government, with the exception, perhaps, of unemployment compensation, you have to make a profit. That's not always the good fortune of new businesses. But at all times you have to pay real estate taxes; at all times you have to confrom with building codes, unless they are relaxed; at all times you have to pay a series of taxes that are part of the expenses of doing business. Occupancy, for instance, is part of the expense of doing business. It could well be that some cities will provide buildings at very low cost, because they've been vacant over a period of time. Interest has always been a large part of the cost of doing business, particularly in these days. The local and State authorities have the ability to issue indebtednesses that can lower or, perhaps, even subsidize the rate of interest. So there are many areas in which there can be State and local participation. And the States and communities will have to bid in tandem. The good part of having a smaller number of enterprise zones is we expect hundreds of bids. In order to have a bid accepted, the bidding parties will have to figure that they're going to have to make some concessions, whether it be in taxes, occupancy, lowering the interest, or providing occupancy. Another important thing, of course, is protection; police and fire. Many of the areas where we anticipate there will be enterprise zones, there is either a lack of, or inadequate police and fire protection. And if you don't have adequate fire protection, of course, you really can't go into business because you can't get insurance. That makes it impossible, because you put everything at risk every moment of the day, and that's not a viable way to do business.

So enterprise zones, I think, are a positive way to bring businesses into distressed areas of the country, particularly, small businesses. Small businesses have created the vast, vast majority of the new jobs in this country. Businesses with under 100 employees create approximately 80 percent of the new jobs in this country. Businesses with under 500 employees create somewhere in the neighborhood of 95 percent of the new jobs in this country. So we're not looking for big businesses. There are very few that are willing to locate. There are very few Control Datas. We happen to be blessed because of their presence in this State. But there are very few Control Datas in the country that are willing to go through the pain and strain of locating in a more distressed area, particularly the city. However, a small businessman who has a sense that he can control the operations of his business, is more likely to take the risks attending to that.

We have hope in this bill. This is not the bill that's going to provide all the hope for the inner city, this is a bill that is not going to replace all the programs that exist on a Federal or a State level for the inner cities, but this is a program that's going to supplement them and, hopefully, be successful, and I think, has a very reasonable possibility of success. I'm a businessman, and many people ask me, "would you locate in an enterprise zone? I say, "yes and no." I wouldn't locate one of my retail businesses in an enterprise zone. You have to be where the people are and where the people are who have money to spend. But I have warehousing operations, and certainly, they would be very appropriate for enterprise zones. The idea of having a very large element of the cost, which is occupancy, in some way underwritten would be appealing.

[The prepared statement of Senator Boschwitz follows:]

STATEMENT BY SENATOR RUDY BOSCHWITZ
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE HEARING
ON
INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

GOOD MORNING. ON BEHALF OF THE SENATE SMALL BUSINESS COMMITTEE, I AM PLEASED TO WELCOME ALL OF YOU TO TODAY'S HEARING ON "INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES". TODAY'S HEARING IS THE FOURTH HEARING HELD BY THIS COMMITTEE TO EXAMINE THE PROBLEMS OF SMALL BUSINESSES IN DISTRESSED AREAS OR "ENTERPRISE ZONES." IN FEBRUARY, I CHAIRED THE COMMITTEE'S WASHINGTON LEAD-OFF HEARING. SINCE THEN COMMITTEE HEARINGS HAVE BEEN HELD IN OAKLAND, CHICAGO, AND TODAY HERE IN ST. PAUL.

I FIRST INTRODUCED LEGISLATION IN THE SENATE TO CREATE ENTERPRISE ZONES NEARLY TWO YEARS AGO. SINCE THEN, I HAVE WORKED TO DEVELOP THE LEGISLATION BECAUSE I BELIEVE THE CONCEPT RESPONSIBLY ADDRESSES THE PROBLEMS OF JOBLESSNESS BY ENLISTING THE HELP OF THE PRIVATE SECTOR. I DO NOT CONTEND THAT ENACTMENT OF ENTERPRISE ZONES WILL BRING THE UNEMPLOYMENT RATE FROM ITS CURRENT LEVEL OF 9 PERCENT TO 6 PERCENT, BUT CERTAINLY IT WILL BE A CONTRIBUTING FACTOR. IN THAT REGARD, I WAS PLEASED TO RECENTLY JOIN IN INTRODUCING THE ADMINISTRATION'S ENTERPRISE ZONE ACT OF 1982, S. 2998, WHICH I EXPECT OUR WITNESSES WILL COMMENT ON TODAY.

THE CONCEPT OF "ENTERPRISE ZONES" RECOGNIZES THAT TO PROVIDE LASTING, MEANINGFUL JOBS TO THOSE LIVING IN DISTRESSED AREAS WE MUST LOOK TO BUSINESS -- PRIMARILY SMALL BUSINESS. SMALL BUSINESSES BECAUSE THEY CREATE THE VAST MAJORITY OF OUR NATION'S NEW PRIVATE SECTOR JOBS. IN THE PAST TEN YEARS, NEARLY 20 PERCENT OF NEW PRIVATE-SECTOR EMPLOYMENT HAS COME FROM BUSINESSES WITH 20 OR FEWER EMPLOYEES. EIGHTY PERCENT OF NEW JOBS HAVE BEEN CREATED BY BUSINESSES WITH LESS THAN 100 EMPLOYEES. THEREFORE, IT IS IMPORTANT THAT AS CONGRESS SHAPES LEGISLATION TO CREATE ENTERPRISE ZONES WE KEEP THE EMPHASIS ON HOW TO HELP SMALL BUSINESSES IN OVERCOMING HURDLES IN LOCATING AND OPERATING IN DISTRESSED AREAS.

AS ONE WHO OWNED AND OPERATED MY OWN BUSINESS HERE IN MINNESOTA BEFORE GOING TO THE SENATE, MY FAITH IN SMALL BUSINESS GOES MUCH DEEPER THAN STATISTICS. MY EXPERIENCE AS A BUSINESSMAN HAS SHOWN ME THAT SMALL BUSINESSES OFFER AN INCREASED OPPORTUNITY FOR RAPID ADVANCEMENT WHEN COMPARED WITH LARGER CORPORATIONS. PEOPLE AT THE LOWER END OF THE WAGE SCALE ARE NOT SO EASILY LOST IN THE SHUFFLE. THE SMALL BUSINESSMAN IS FAR MORE INVOLVED WITH THE LIVES OF HIS EMPLOYEES. A WORKER'S QUALITIES, PROBLEMS, FAMILY, AND AMBITIONS DO NOT EASILY ESCAPE THE BOSS' NOTICE.

GETTING IN ON THE GROUND FLOOR OF A SMALL BUSINESS IS A VERY EFFECTIVE METHOD OF ADVANCEMENT, BUT MOST IMPORTANTLY, IT IS A STARK CONTRAST FROM WELFARE.

SO I VIEW THE BILL, AND ENTERPRISE ZONES, FROM A BUSINESSMAN'S PERSPECTIVE. THERE ARE MANY TAX INCENTIVES IN THIS BILL, SUCH AS ELIMINATION OF CAPITAL GAINS TAXES FOR BUSINESS INVESTMENT, AN INCREASE IN INVESTMENT TAX CREDITS AND A FIFTY PERCENT TAX CREDIT FOR WAGES PAID TO PREVIOUSLY UNEMPLOYED DISADVANTAGED WORKERS.

BUT THERE ARE OTHER PROBLEMS FACED BY SMALL BUSINESSES WISHING TO LOCATE IN ENTERPRISE ZONES THAT CANNOT BE CORRECTED BY THE FEDERAL GOVERNMENT ALONE. SUCH PROBLEMS AS CRIME, WEAK INFRASTRUCTURE SUPPORT AND CITY TAXES REMAIN BARRIERS TO BUSINESS DEVELOPMENT. THESE SERVE AS A DOUBLE WHAMMY WHEN YOU CONSIDER THAT A PROSPECTIVE BUSINESS ALREADY FACES THE USUAL PROBLEMS OF TAX BURDENS, START-UP CAPITAL AND TECHNICAL EXPERTISE.

WE HAVE TACKLED THIS PROBLEM BY COMBINING INCENTIVES PROVIDED BY THE FEDERAL GOVERNMENT WITH THOSE OF LOCAL GOVERNMENTS. THAT AN AREA SHOWS SIGNS OF HIGH UNEMPLOYMENT, POVERTY, OR OUTMIGRATION IS NOT ENOUGH TO QUALIFY FOR AN ENTERPRISE ZONE DESIGNATION. THE LOCAL GOVERNMENT MUST ALSO ASSEMBLE A PACKAGE OF TAX AND OTHER INCENTIVES THAT MEET THE PARTICULAR PROBLEMS OF THE AREA. MOREOVER, THE AWARD OF AN ENTERPRISE ZONE WILL BE GRANTED ON A COMPETITIVE BASIS TO TEST LOCAL COMMITMENT. THAT COULD INCLUDE ANY NUMBER OF THINGS, SUCH AS IMPROVED INFRASTRUCTURE SUPPORT, REDUCTION OF LOCAL TAXES, RELAXATION OF LOCAL REGULATIONS, MANAGERIAL ASSISTANCE AND TECHNICAL HELP.

THOSE LOCAL CONTRIBUTIONS ARE THEN MATCHED BY FEDERAL TAX BREAKS, SUCH AS THE ELIMINATION OF CAPITAL GAINS TAXES FOR BUSINESS

INVESTMENT IN THE AREA, SIGNIFICANT REDUCTIONS IN INCOME TAXES, AND A TAX CREDIT FOR WAGES PAID TO PREVIOUSLY UNEMPLOYED WORKERS. THIS LOCAL/FEDERAL PACKAGE ADDRESSES THE PROBLEMS THAT ALL SMALL BUSINESSES FACE, AS WELL AS THE PARTICULAR PROBLEMS OF A BUSINESS LOCATED IN A DEPRESSED AREA.

CLEARLY, WE NEED A NEW APPROACH IN ASSISTING OUR POOR AND JOBLESS. THE CURRENT ANTI-POVERTY PROGRAMS DO PROVIDE CRUCIAL SERVICES BUT DO NOT, ON THEIR OWN, APPEAR TO ACHIEVE ANY LASTING GOOD. THEY ARE FOR THE MOST PART STOP-GAP POLICIES THAT ADDRESS THE SYMPTOMS BUT NOT THE CAUSES OF POVERTY. THEY HAVE FAILED TO PROVIDE ANY MEANINGFUL OPPORTUNITY FOR ADVANCEMENT.

IN FACT, THE PRESENT SYSTEM HAS TRAPPED MANY OF OUR POOR IN A SELF-PERPETUATING CYCLE OF POVERTY. INSTEAD OF OFFERING THE POOR A CHANCE TO PULL THEMSELVES AND THEIR FAMILIES OUT OF POVERTY, THE PRESENT PROGRAMS UNWITTINGLY TRAP RECIPIENTS IN A SELF-PERPETUATING QUAGMIRE OF POVERTY, FROM WHICH EVEN THE MOST ENTERPRISING HAVE TROUBLE EMERGING.

THESE ARE SOME OF MY VIEWS ON HOW THE LEGISLATION ON ENTERPRISE ZONES CAN WORK TO HELP REVITALIZE AND REDEVELOP DISTRESSED AREAS.

LET US NOW HEAR FROM OUR WITNESSES WHO HAVE COME TO GIVE US THEIR VIEWS FROM A LOCAL PERSPECTIVE ON THIS SUBJECT.

Senator **Boschwitz**. We have a series of witnesses this morning and, while we have some people from the political world, we have tried to balance it off with people from business, because, frankly, in Washington we just hear from a series of politicans. So we have tried to include in our list of witnesses this morning people from the business world. With that foreword, I introduce Senator Jim Ulland who is from the political world but a long-term friend and a person particularly familiar with the problems of the northern regions of our State, where we hope that the Enterprise Zone Act will have some early application. Senator Ulland.

STATEMENT OF HON. JAMES ULLAND, STATE SENATOR, ST. PAUL, MINN.

Mr. **Ulland**. Senator Boschwitz, it's my pleasure to be here on this important topic. Particulary important for me, because, as you know, I represent Duluth, and Duluth has both the opportunity of being substantially benefited by the enterprise zone concept. At the same time, we're confronted with really serious economic problems. The reason we're specifically confronted with difficult economic problems is our community relies on three major sources of employment that are under stress: Taconite, which is the—Minnesota produces the largest tonnage of taconite in the country. We're directly tied to the steel industry and we're experiencing an operation level of 50 percent of capacity in that major industry.

The second major area of employment in Duluth and the Duluth area, northeastern Minnesota, is in the wood fiber industry. That's suffering equally and directly with the housing slump. It's no mystery that we should suffer that way. Only the paper component of wood fiber has held up and retained its employment. Even that now is under some stress.

The third area with which you are exceptionally familiar is that Duluth is a major port. Minnesota's world port. We suffered, I think, uniquely with the grain embargo under the previous administration. The year prior to that embargo we had 56 Russian ships hauling feed grain out of Duluth. They were our largest customer. Last year we had one Soviet ship in Duluth. This year so far we've had two. So in effect the embargo cost us our major customer, and I think it cost us our major customer on a long-term basis. So our third major area of employment is under, I think, a long-term seige, if you will.

The only area where we find some comfort is that tourism is healthy, although it certainly can't sustain the community alone. That's why the community greets with enthusiasm your concept, and we hope that its speedy implementation will occur. We hope that because our economy continues to deteriorate. In 1960 the census had Duluth at 106,000, which was its peak population. The 1980 census has us between 92,000 and 93,000. It's always more difficult to manage a declining economy than either a stable economy or one that has an increasing population.

As you look through the legislation—I'm going to suggest a couple technical areas which Jack LaVoy from the city of Duluth will explain a little more fully at the end of those people scheduled to testify—because some of the ways the competition will occur might be better served if there was slight modifications. The first one I call to your attention is when we're looking at propulation decrease. If you look—the legislation, the proposed legislation calls for—appears to call for looking at each census tract to see that a census tract has experienced a 20-percent population decrease. What we feel to get a better district is to have the applicant district of an average population decrease of 20 percent rather than to have each census tract experience a 20-percent decrease. We can get a more homogeneous district in Duluth if we use the average of the census tracts included in the district rather than singling out census tracts individually. The——

Senator BOSCHWITZ. Just one of the things, that 20-percent decrease.

Mr. ULLAND. That's right.

We also are more comfortable with your—the initial way you introduced the legislation which used the 10-percent criteria rather than the 20-percent. We will qualify in a major industrial area with the 20-percent, but we have one portion of it which is a good industrial—was a good industrial area, is a good industrial site, but we built a senior citizens high rise in the site so—in that census tract, so even though the population is substantially declined, the housing has deteriorated, we've moved in about 500 senior citizens on one point and that stabilized—that returned the population in that particular census tract to one where it couldn't show the 10—the 20-percent decline.

Senator BOSCHWITZ. Draw the line around that building.

Mr. ULLAND. Except that, Senator, I think that when we talk about census tracts, that you have to probably stay on the boundaries of the census tracts if that's going to be the source of your information.

Senator BOSCHWITZ. It is not our intention that we stay on census tract lines. We will take that up, though, to make sure that the regulators don't—pardon me for interrupting you, Senator—put that into the regulation, because they certainly are quite capable of doing that.

Do you have any comments on that?

Mr. WILSON [shaking head in the negative].

Senator BOSCHWITZ. It was not—was it intended to be in the committee deliberations that you participated in on census tract line?

[Whereupon a discussion was held off the record.]

Senator BOSCHWITZ. We take a more pragmatic view in the committee and we'll watch that so the regulations are not so drawn that you can't skirt around something like that.

Mr. ULLAND. Thank you. The second area that would be trying to see the average for both the population decline within the enterprise zone district, rather than by census tract. So you wind up still using—still arriving at your—your basic figure but use an average of the census tracts within the zone rather than going census tract by cenus tract. I think if you go census tract by census tract you're going to have a problem of contiguousness within the district, because as you look as an industrial area, it's conceivable of having one census tract. If you got a narrow area and many of the industrial areas are, you could have one census tract in there that, for instance, would not qualify. Thus, you'd have a poorly formed district. By the taking the average for a population decline and the average for poverty throughout the census tracts included in the enterprise zone, I think you're going to wind up with better zones that if you simply go by census tracts. Because I don't know [illegible]ho drew census tracts or out of what purpose census tracts [illegible] drawn, but they certainly weren't drawn with—with this in m[illegible] and with an idea of conforming to that.

Another item that in Duluth we feel would be important to include in the list of criteria is one we included in our State legislation which we passed this last session, attempting to conform, at least in the spirit of the legislation that you—that you're proposing before it had become passed. What we said is another, additional criteria would be if a major Federal facility had closed within the jurisdiction of the municipality making application, that this would lend weight to that application. Of course, we're speaking to the number of defense—generally, the number of defense closures around the country. The defense department is under some obligation to provide relief and assistance, and I think by making that one of the variables upon which applications are judged, that we would fulfill a dual purpose there of assisting the Defense Department and assisting the goals that you've put forth.

Finally, the committee, and I urge you to ask the committee to consider once you—once an enterprise zone is established, if the adjoining State has a qualifying district—and Duluth, I'm thinking about Superior, Wis.—if the adjoining State has a qualifying district, and Superior would qualify, then I think it would be reasonable to allow the extension of the zone if it's contiguous into that adjoining city, that would serve both communities, getting them out of the economic rivalry which I don't think serves either community well; and second, it would allow a larger number of contiguous enterprise zones to be used and a larger number of States to be involved in those instances where you have contiguous cities on State borders. And there are a number of those, whether—East St. Louis and St. Louis are adjoining cities, both——

Senator BOSCHWITZ. I believe, Senator, that can now be done under the bill as it exists, just that the various communities or governmental units should act in concert when they make application, but no reason why Duluth and Superior, as an example, and New York and Newark, or St. Louis and East St. Louis cannot act together.

Mr. ULLAND. We considered a joint application. The difficulty there is that some States will be ahead of others in their ability to respond to the legislation. Currently, Wisconsin has not passed their enabling legislation in attempt to conform. So what—although we think that joint application is helpful, and maybe helpful in a number of instances, we think also the concept of extending the zone once one is established is also helpful and would allow for Duluth, perhaps, to extend its zone to encompass a portion of Superior, Wis. Now, to do that——

Senator BOSCHWITZ. I don't believe that we got into expansion zones once it was created.

[Whereupon a discussion was held off the record.]

Senator BOSCHWITZ. No. There is no provision for that, and I don't argue with your conclusion.

[Whereupon a discussion was held off the record.]

Senator BOSCHWITZ. We have been talking to HUD about the possibility even after approval of having an enterprise zone change its borders, so we can look at that also with respect to the regulations. I suppose with approval there's no reason that could not be done.

Mr. ULLAND. The one portion of the rules that might have to be waived in that instance would be the 5-square-mile limitation for the zone. It may not have to be, but if you're going to accommodate an additional city and additional State, it might be reasonable to provide for some flexibility in the square-mile designation.

Senator BOSCHWITZ. I recall that limitation, Senator, now that you mention it. But I believe it has been removed. There have been so many forms of this bill that have come along that I have been confused, also. And I don't disagree with your opening remarks that the bill as we introduced it had some advantages over the present form of the bill. As you well know, the business of politics is also a business of compromise and the art of the possible and getting things done. In order to get the administration on the board, in order to get the President's endorsement. We did make some changes, and it's just one of them.

Mr. ULLAND. I just wanted to alert you to—to what would be our preference in case when—if the House of Representatives takes a different position, that at least you would have our feeling on what would be more beneficial to Duluth. That concludes my remarks for this morning and I'm pleased to be with you.

Senator BOSCHWITZ. Well, I thank you, Senator. I am quite familiar with the problems of the Duluth area. I have been quite involved with some members of the Duluth community who are here in the room, trying to help remedy some of the problems that you have. I've gotten involved even with taconite now because the World Bank is considering making a loan to Brazil in which our Government would have approximately a 22-percent share, and we would make a loan that might further undermine the ability of the range to recover, and further flood the world market with ore. While this country takes a rather open a viewpoint to the importation of steel, hopefully, the affairs of the northern part of our State will improve. I have been working as well with the steel industry down in Washington in their effort to process a large number of cases which very clearly indicate something, various degrees, at three, four, $500 a ton. As countries either pay the losses that their steel producers encounter or in some other way subsidize the low interest rates, the tax relief, some of the tonnage that is made in their country. Also, I've toured your seaway, so I'm familiar with that as well.

You happen to touch upon areas of my interest, and I think that we have made some progress with respect to our dealings with the Russians. We've pretty well convinced the Department of State that embargoes are not a useful act; embargoes of plungable [ph.] goods, of grains, and as a result they now take a rather strong view that the grain embargo would not accomplish anything. If they continue to take that view, I think we, perhaps, will see a restoration of some trade with the Russians.

Senator **Boschwitz**. Senator Ulland, we thank you for testifying this morning. And hope that we can find an enterprise zone in your neck of the woods.

[The prepared statement of Mr. Ulland follows:]

STATEMENT BY STATE SENATOR JAMES ULLAND

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE HEARING

ON

INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONES

Dear Mr. Chairman and Committee Members:

The city which I represent is Duluth, Minnesota, a city currently confronting serious economic problems and one which would be substantially benefited by the Enterprise Zone concept.

Duluth's economy is directly affected by three major economic variables: The first is the steel industry. Since Minnesota is the largest producer of taconite in the United States, the sharp downturn in the national steel industry has reduced production of taconite to 50% of capacity. Taconite mining is our largest area employer. The second major economic variable is the housing industry. Northern Minnesota is a chief supplier of wood fiber products and has suffered accordingly from the housing slump. Only our paper making processes have not experienced a steep economic downturn. The third variable is agriculture exports through the St. Lawrence Seaway. Duluth and the seaway are still suffering the serious adverse impact of the grain embargo. The Soviet Union was the port of Duluth's chief customer for feed grains. In the season prior to the embargo, 56 Russian ships visited the port of Duluth. Last year that number was reduced to one. We find the seaway confronting additional uncertainty with the cost recovery considerations being discussed in the Senate.

The results of the three variables I have outlined to you are not surprising. We have higher unemployment than the national average, a declining tax base, and a drop in population from a high of 106,000 in 1960 to approximately 92,000 in the 1980 census.

Duluth receives the legislative proposal before you with enthusiasm.

I do wish to call to your attention some of the areas in that proposal which merit some modification or further review.

1. The first area for clarification occurred in the amount of population decrease per census district that is used to qualify. In Duluth we would hope that the population decrease variable that is used would be an average of the proposed district rather than having each census tract qualify individually.
2. Additionally, we would prefer the 10% decline in population as a criteria rather than the 20% figure currently in the legislation.

Duluth would be able to have a slightly expanded district in in a normal industrial area with the 10% level. One of our census tracts which is an industrial area and has experienced a general and substantial decline of population was chosen as a site for a senior citizen high rise and thus could only be included in the zone using the averaging concept and the 10% decline in population rule.

3. In the legislation, the poverty rate of 20% appears to apply to each census tract individually. It would be more helpful in the Duluth situation, and I assume for other cities, if this were an average over the proposed district rather than by census tract.

4. When Minnesota adopted its legislation attempting to conform with the Enterprise Zone concept we did add an additional criteria which was the closure of a major federal government facility within the jurisdiction of the city submitting a proposal for an enterprise zone.

5. The committee might consider the extension of an enterprise zone once one is declared, across state lines should the contiguous area in the ajoining state meet the criteria that has been outlined Across Duluth harbor is Superior, Wisconsin, which is suffering similar economic hardship. The State of Wisconsin has not yet passed their legislation attemption to conform with the legislation you are considering. To allow an enterprise zone to expand across state borders where the need exists would allow the participation of a second area in a second state under one designation. To do this, the five square mile restriction would most likely have to be removed.

For your information, I've attached the Minnesota law to my prepared remarks for your review. It has been a pleasure testifying before your committee today and to discuss the refreshing approach to job creation.

JAMES ULLAND
State Senator

ARTICLE VI

Section 1. Minnesota Statutes 1981 Supplement, Section 273.13, Subdivision 9, is amended to read:

Subd. 9. [CLASS 4A, 4B ~~AND~~, 4C, AND 4D.] (1) All property not included in the preceding classes shall constitute class 4a and shall be valued and assessed at 43 percent of the market value thereof~~,~~, except ~~that~~ as otherwise provided in this subdivision.

(2) Real property which is not improved with a structure and which is not utilized as part of a commercial or industrial activity shall constitute class 4b and shall be valued and assessed at 40 percent of market value~~, and except that~~.

(3) Commercial and industrial property, except as provided

in this subdivision, shall constitute class 4c and shall be valued and assessed at 40 percent of the first $50,000 of market value and 43 percent ~~on~~ of the remainder, provided that in the case of state-assessed commercial or industrial property owned by one person or entity, only one parcel shall qualify for the 40 percent assessment~~s~~, and in the case of other commercial or industrial property~~, other than state-assessed properties,~~ owned by one person or entity, only one parcel in each county shall qualify for the 40 percent assessment.

(4) Industrial employment property defined in section 2, during the period provided in section 2, shall constitute class 4d and shall be valued and assessed at 20 percent of the first $50,000 of market value and 21.5 percent of the remainder.

Sec. 2. [273.1312] [DESIGNATION OF ENTERPRISE ZONES.]

Subdivision 1. [DEFINITIONS.] For purposes of this section:

(1) "Commissioner" means the commissioner of energy, planning and development.

(2) "Enterprise zone" means an area in the state designated as such by the commissioner upon proper application by the governing body of the area in which it is located.

(3) "Governing body" means the county board of a county except with respect to an area in a city, whose governing body is the city council or other body designated by its charter, or an area constituting part or all of an Indian reservation, whose governing body is that tribal or federal agency recognized as such by the United States secretary of the interior.

(4) "HUD" means the United States secretary of housing and urban development or his delegate or successor.

(5) "Indian reservation" means an area determined to be such by the United States secretary of the interior.

(6) "SMSA" means a standard metropolitan statistical area as defined in section 103A(1)(4)(B) of the Internal Revenue Code of 1954, as amended through December 31, 1981.

Subd. 2. [DESIGNATION.] The commissioner shall designate an area as an enterprise zone if (i) an application is made in the form and manner and containing the information prescribed by the commissioner's rules; (ii) the application is made or approved by the governing body of the area; and (iii) the area is determined by the commissioner to be eligible for designation under subdivision 4.

Subd. 3. [DURATION.] The designation of an area as an enterprise zone shall be effective from the date of designation to 12 years thereafter.

Subd. 4. [ELIGIBILITY REQUIREMENTTS.] An area is eligible for designation if:

(1) Its boundary is continuous and includes, if feasible, proximately located vacant or underutilized lands or buildings conveniently accessible to residents of the area.

(2) Its population as determined under the most recent federal decennial census is at least (i) 4,000 if any of the area is located within an SMSA with a population of 50,000 or more, or (ii) 2,500 in any other case unless the area is an Indian reservation, for which no minimum population is required.

(3) (a) The proposed zone is located within an economic hardship area, as established by meeting three or more of the following criteria:

(1) the percentage of total residential housing units within the zone which was constructed prior to 1950 is 70 percent or greater;

(2) the percentage of households within the zone that fall below the poverty level, as determined by the United States census bureau, is 20 percent or greater;

(3) the total number of persons residing within the zone has declined by ten percent or more over the ten years preceding application;

(4) for the last full year for which data is available, the percentage of the work force of the jurisdiction of the governing body of the area in which the zone is located engaged in manufacturing is less than the percentage of the work force of the state engaged in manufacturing;

(5) the jurisdiction of the governing body of the area in which the zone is located has recently experienced a significant

employment reduction at a federal military installation within the SMSA in which it is located; or

(b) The area is so designated under federal legislation providing for federal tax benefits to employers or employees in enterprise zones similar to the state tax benefits set forth in this act; and

(4) The governing body of the area seeking to be designated as an enterprise zone, by resolution, agrees to follow a course of action, during the period for which the designation is effective, designed to promote economic development in the area. The program may be implemented by governmental action, by private entities, or both, and may include but is not limited to:

(a) Reduction or abatement of real property taxes of industrial land and facilities according to section 3;

(b) Issuance of revenue bonds or use of federal funds available to finance loans for private industrial and housing facilities;

(c) Issuance of bonds and use of taxes, tax increments, and available federal funds to finance public facilities in the area;

(d) Increase in the level or efficiency of governmental services;

(e) Commitments from public or private entities in the area to provide jobs, job training, and technical, financial, or other assistance to employees and residents of the area.

Subd. 5. [LIMITATION.] No area shall be designated as an enterprise zone after December 31, 1996.

Sec. 3. [273.1313] [TAX CLASSIFICATION OF INDUSTRIAL EMPLOYMENT PROPERTY.]

Subdivision 1. [DEFINITIONS.] (1) Terms used in this section have the meanings given them in this subdivision.

(2) "Commissioner" means the commissioner of revenue.

(3) "Industrial employment property" means taxable property, excluding land but including buildings, structures, fixtures, and improvements that satisfy each of the following conditions:

(a) The property is located within an enterprise zone designated according to section 2.

(b) The primary purpose and prospective use of the property is (i) the manufacture or processing of goods or materials by physical or chemical change, or (ii) the provision of office, engineering, research and development, warehousing, parts distribution, or other facilities that are related to a manufacturing or processing operation conducted by the user.

(c) The user will own the property or occupy it under a lease requiring the user to pay property taxes on it as if the user were the owner.

(c) The property is classified as industrial employment property by the procedure and subject to the conditions provided in this section, before it is first placed in use.

(4) "Market value", as applied to industrial employment property on any particular parcel of land, means the value of all taxable property situated there except the land, as annually determined pursuant to section 273.12, less (i) the market value of all property existing at the time of application for classification, as last assessed prior to the time of application, and (ii) any increase in the market value of the property referred to in clause (i) as assessed in each year after the industrial employment property is first placed in service. In each year, any change in the values of the industrial employment property and the other property on the land shall be deemed to be proportionate unless caused by a capital improvement or loss.

(5) "Municipality" means any home rule charter or statutory city or county, but a county may not exercise the powers granted in this section with reference to property situated within a city.

Subd. 2. [PROGRAM.] (1) The governing body of any municipality which contains a designated enterprise zone as provided by section 2 may by resolution establish a program for classification of new industrial property or improvements to existing property as industrial employment property pursuant to the provisions of this section, if it finds that the program is needed to facilitate and encourage the renewal or addition of industrial facilities to provide or preserve employment opportunities for its citizens. Applications for classification under the program shall be filed with the municipal clerk or auditor in a form prescribed by the commissioner, with additions as may be prescribed by the municipal governing body. The application shall contain a legal description of the parcel of land on which the facility is to be situated or improved; a general description of the facility or improvement and its proposed use, the equipment proposed to be used in connection with it (including equipment exempt from taxation under existing law), the probable time schedule for undertaking the construction or improvement, and information regarding the matters referred to in paragraph (4); the market value and the assessed value of the land and of all other taxable property then situated on it, according to the most recent assessment; and an estimate of the probable cost of the new construction or improvement and the market value of the new or improved facility (excluding land) when completed.

(2) Upon receipt of an application the municipal clerk or auditor, subject to any prior approval required by the resolution establishing the program, shall furnish a copy to the assessor for the property and to the governing body of each school district and other public body authorized to levy taxes on the property, and shall publish a notice in the official newspaper of the time and place of a hearing to be held by the governing body on the application, not less than 30 days after the notice is published, stating that the applicant, the assessor, representatives of the affected taxing authorities, and any taxpayer of the municipality may be heard or may present their views in writing at or before the hearing. The hearing may be adjourned from time to time, but the governing body shall take action on the application by resolution within 30 days after the hearing. If disapproved, the reasons shall be set forth in the resolution, and the applicant may appeal to the commissioner within 30 days thereafter, but only on the ground

that the determination is arbitrary, in relation to prior determinations as to classification under the program, or based upon a mistake of law. If approved, the resolution shall include determinations as to the matters set forth in paragraph (4), and the clerk or auditor shall transmit it to the commissioner.

(3) Within 60 days after receipt of an approved application or an appeal from the disapproval of an application, the commissioner shall take action on it. The commissioner shall approve each application approved by the governing body if he finds that it complies with the provisions of this section. If he disapproves the application, or finds grounds exist for appeal of a disapproved application, he shall transmit the finding to the governing body and the applicant. When grounds for appeal have been determined to exist, the governing body shall reconsider and take further action on the application within 30 days after receipt of the commissioner's notice and serve written notice of the action upon the applicant. The applicant, within 30 days after receipt of notice of final disapproval by the commissioner or the governing body, may appeal from the disapproval to a court of competent jurisdiction.

(4) An application shall not be approved unless the governing body finds and determines that the construction or improvement of the facility:

(a) Is reasonably likely to create new employment or prevent a loss of employment in the municipality;

(b) Is not likely to have the effect of transferring existing employment from one or more other municipalities within the state;

(c) Is not likely to cause the total market value of industrial employment property within the municipality to exceed five percent of the total market value of all taxable property within the municipality; or if it will, the resulting limitation upon the increase of the assessed value of all taxable property within the municipality, considering the amount of additional municipal services likely to be required for the industrial employment property, is not likely to substantially impede the operation or the financial integrity of the municipality or any other public body levying taxes on property in the municipality; and

(d) Will not result in the reduction of the assessed value of existing property within the municipality owned by the applicant, through abandonment, demolition, or otherwise, without provision for the restoration of the existing property within a reasonable time in a manner sufficient to restore the assessed valuation.

Subd. 3. [CLASSIFICATION.] Property shall be classified as industrial employment property and assessed as provided for class 4d property in section 273.13, subdivision 9, clause (4), for taxes levied in the year in which the classification is approved and in each year thereafter to and including the 12th year after the industrial employment property is completed. If the classification is revoked, the revocation is effective for taxes levied in the next year after revocation.

Subd. 4. [REVOCATION.] The governing body of the municipality may request the commissioner to approve the revocation of a classification pursuant to this section if it finds and determines by resolution, after hearing upon notice mailed to the applicant by certified mail at least 60 days before the hearing, that:

(a) The construction or improvement of the facility has not been completed within two years after the approval of the classification, or any longer period that may have been allowed in the approving resolution or may be necessary due to circumstances not reasonably within the control of the applicant; or

(b) The applicant has not proceeded in good faith with the construction or improvement of the facility, or with its operation, in a manner which is consistent with the purpose of this section and is possible under circumstances reasonably within the control of the applicant.

Subd. 5. [HEARING.] Upon receipt of the request, the commissioner shall notify the applicant and the governing body by certified mail of a time and place, not less than 30 days after receipt, at which the applicant may be heard and the commissioner will determine whether the facts and circumstances are grounds for revocation as recommended by the governing body. If the commissioner revokes the classification, the applicant may appeal from the commissioner's order to a court of competent jurisdiction at any time within 30 days after revocation.

Sec. 4. [EFFECTIVE DATE.]

This article is effective July 1, 1983.

Senator **Boschwitz**. The next witness is Sally Howard, alderwoman from Minneapolis. And, Sally, we welcome you and we look forward to hearing your testimony.

STATEMENT OF HON. SALLY HOWARD, ALDERWOMAN, MINNEAPOLIS CITY COUNCIL, MINNEAPOLIS, MINN.

Ms. **Howard**. Thank you, Senator Boschwitz. Before I begin my prepared remarks, I just want you to know that we appreciate the chance to speak to you about the enterprise zone bill and we continue to support it. We're going to today talk a little about the possibility of another way to structure the enterprise zone which would, perhaps, even help Senator Ulland up in Duluth, but I'll go through my remarks and, perhaps, you can ask questions.

Senator **Boschwitz**. Do you have any prepared remarks?

Ms. **Howard**. I have prepared remarks, mine; and I have 50 copies of my remarks.

Senator **Boschwitz**. Good.

Ms. **Howard**. And then I have a document coming that is four pages long, because you had said 5 minutes is as much as you wanted.[1]

Senator **Boschwitz**. Well, we will make all of that part of the record without objection.

Ms. **Howard**. Great.

Senator **Boschwitz**. And——

Ms. **Howard**. Proposals for the urban enterprise zone represent the significantly difference—a different approach to urban revitalization that deserves the closest consideration.

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[1] Material not received at time of going to press.

The legislation sponsored by Senator Boschwitz and his cosponsors in the Senate, its counterpart legislation in the House, and the administration's proposals for enterprise zones have been carefully analyzed by the city of Minneapolis in light of the city's problems and needs.

Minneapolis clearly qualifies under the proposed legislation. It has more than one area eligible for zone designation. It has difficulty, however, in matching the development incentives proposed in the urban enterprise zones with the city's revitalization needs.

Urban enterprise zones as currently proposed appear directed toward problems of devastatingly blighted areas in older, very severly distressed cities. The proposed legislation offers incentives that may be necessary in such areas, where problems have become so severe that private reinvestment cannot be attracted in any other way without prohibitive public costs.

In Minneapolis, however, as in many other cities of its age and character, the need is for more modest Federal incentives and greater local flexibility in matching an enterprise zone approach to specific local problems.

Our needs in Minneapolis—our need in Minneapolis is to reverse trends of urban decline, not massive rebuilding of large, decayed urban districts—for some assistance now that can be tailored to our needs, to forestall much more costly public incentives and assistance in the future years.

Minneapolis, therefore, supports the enterprise zone proposals as now advanced for these cities with the very severe problems of blight and disinvestment for which the proposals have been best suited. It urges that criteria for designation of zones to receive the full Federal incentive package be made more restrictive, to assure that those cities most in need of them will benefit.

At the same time, the city urges that a second category of enterprise zones be added to the legislation now under consideration. This category should be accessible to a larger number of cities. It should involve fewer Federal incentives—only such as would clearly assist small business needs, particularly needs for venture capital, and allow private firms to offset costs of hiring and training unemployed persons.

The legislation should allow States to establish standards for eligible cities. It should permit the Federal administering agency to accept any zone in this second category for which State and local governments committed themselves to a certain number of actions to encourage private investment and foster revitalization. Instead of designating their incentives to meet the needs of a Federal competition for a zone designation, States and localities could tailor them to their specific needs. The second category of zones should permit more than one zone per city, or even designation of an entire city as a zone, if warranted, but restrict the proportion of a State's population that could be included in designated cities.

In particular, the new category of enterprise zone I am suggesting should address the needs of small business, and of the unemployed. To this end, the legislation should seriously consider providing tax credits to individuals and institutional investors in small business, and tax credits to zone employers for hiring unemployed and underemployed residents throughout the city. And, also, we should think about the possibility of tax credit for child care.

Thank you for the opportunity to make what I hope are constructive suggestions for developing urban enterprise zone legislation to help not only Minneapolis, but many cities, cities that need a little help now to keep their problems from becoming much worse in the future.

[The prepared statement of Ms. Howard follows:]

STATEMENT OF HON. SALLY HOWARD, ALDERWOMAN, MINNEAPOLIS CITY COUNCIL, MINNEAPOLIS, MINN.

Proposals for "Urban Enterprise Zones" represent a significantly different approach to urban revitalization that deserves the closest consideration.

The legislation sponsored by Senator Boschwitz and his co-sponsors in the Senate, its counterpart legislation in the House, and the Administration's proposals for Enterprise Zones have been carefully analyzed by the City of Minneapolis in the light of the City's problems and needs.

Minneapolis clearly qualifies under the proposed legislation. It has more than one area eligible for Zone designation.

It has difficulty, however, in matching the development incentives proposed in Urban Enterprise Zones with the City's revitalization needs.

Urban Enterprise Zones as currently proposed appear directed toward the problems of devastatingly blighted areas in older, very severely distressed cities. The proposed legislation offers incentives that may be necessary in such areas, where problems have become so severe that private re-investment cannot be attracted in any other way without prohibitive public costs.

In Minneapolis, however, as in many other cities of its age and character, the need is for more modest Federal incentives and greater local flexibility in matching an Enterprise Zone approach to specific local problems.

Our need is to reverse trends of urban decline, not massive rebuilding of large, decayed urban districts—for some assistance now that can be tailored to our needs, to forestall much more costly public incentives and assistance in future years.

Minneapolis, therefore, supports the Enterprise Zone proposals as now advanced for these few cities with the very severe problems of blight and disinvestment for which the proposals seem best suited. It urges that criteria for designation of Zones to receive the full Federal incentive package be made more restrictive, to assure that those cities most in need of them will benefit.

At the same time, the City urges that a second category of Enterprise Zones be added to the legislation now under consideration.

This category should be accessible to a larger number of cities. It should involve fewer Federal incentives—only such as would clearly assist small business needs (particularly needs for venture capital), and allow private firms to offset costs of hiring and training unemployed persons.

The legislation should allow States to establish standards for eligible cities. It should permit the Federal administering agency to accept any Zone in this second category for which State and local governments committed themselves to a certain number of actions to encourage private investment and foster revitalization. Instead of designing their incentives to meet the needs of a Federal competition for Zone designation, States and localities could tailor them to their specific needs.

The second category of Zones should permit more than one Zone per city, or even designation of an entire city as a Zone if warranted, but restrict the proportion of a State's population that could be included in designated cities.

In particular, the new category of Enterprise Zones I am suggesting should address the needs of small businesses, and of the unemployed. To this end, the legislation should seriously consider providing tax credits to individual and institutional investors in small businesses, and tax credits to Zone employers for hiring unemployed and underemployed residents throughout the City.

Thank you for the opportunity to make what I hope are constructive suggestions for developing Urban Enterprise Zone legislation to help not only Minneapolis but many cities—cities that need a little help now to keep their problems from becoming much worse in the future.

Senator **BOSCHWITZ**. First, the number of zones per city is not limited to one under the present legislation. Let me comment on your testimony and then ask some questions, if I may. We went through some of the tax credits to individual and institutional investors. I think if there is a drawback to the bill, the principal drawback is that we don't do more. I'm not sure, we may do that through amendent on the floor of the Senate, or to try to provide tax credits or a deductibility of some type for investors, a certain share of their investment either in the first year, the second year, or third year, but relatively quickly.

We encountered some opposition from the Treasury. Whenever you come up with an idea, they begin to oppose anything that will mean a reduction in revenue. And we went through some very expansive negotiations to get to the point at which we are. We can introduce amendments on the floor of the Senate, and the floor of the House, particularly in the area of deductibility or tax credits for investment. It would certainly be constructive, in my judgment, for obtaining investors, and that will be, perhaps, among the hardest aspects of attracting small businesses to enterprise zones.

We did not intend in this legislation to direct the enterprise zone only at what you call large, decayed urban districts. Certainly, we could easily put 25 enterprise zones several years into large, decayed urban districts. That's why, in my opening remarks, I specifically mentioned Clearwater County, which is one of the reasons we have a smaller population designation—to accommodate the rural counties. And because there is a 24-percent unemployment, perhaps, the whole county can be included. But it is not the object of this legislation to only apply it to large, decayed urban districts. It will be my hope and my advice to HUD in stressing to them what thinking went on in the formation of this bill. We will do that through report language and the bill as it develops. Hopefully, they'll see that we want enterprise zones to be tried not only in large, decayed urban areas, but to be tried in other areas as well, so that we can get a sense of how they work and what the response is. And it may be that the response is not good right in the midst of a decayed area, but, perhaps, at the periphery, but not out in the suburbs, but along the peripheries of decayed areas. All kinds of things should be tried, and I trust that Department of Housing and Urban Development will be enterprising in their approach to the enterprise zone bill.

Ms. **Howard**. Well, Senator, we will be eligible under the current language, and I think that the reason that we kind of changed our statement, because we were—we've always been wholly supportive of the Urban Enterprise Zone Act, but as we were looking at making ourselves eligible, we saw that we could, but we also saw that our problems are not as severe as some of our friends in our—in other urban areas. So the reason we started talking about the possibility of a second category is that we didn't feel it's fair for us to be designated by HUD as one of a limited number of—of urban enterprise zones with the full activity that—that the Federal Government suggests or that this bill suggests we could use. That instead we would—because there are lots of cities like Minneapolis, and I would include Seattle, as an example, and Portland—there are a number of cities that are like we are that still have problems. But we have pockets of problems rather than blocks of problems. You know, there's no place in Minneapolis where you have six blocks of abandoned buildings, you know, absolutely gone—gone down the drain. And our suggestion was that we would—we would still need help to help those pockets that we have problems with. But, perhaps, your point is well taken, you'd like to see a variety of kinds of urban enterprise zones happening at the same time. A Detroit, a Minneapolis, and a Watts, whatever, operating at the same time with all of the same goodies available.

Senator Boschwitz. That's right. And just the fact that the whole act applies to Minneapolis, and still within its definition applies to Minneapolis, is a restatement of our intention that we don't just want to pick out the worst, the most decayed. Quite clearly, that's the most difficult part to make things happen, in my judgment, and there are unemployed people in other areas of the country as well.

I will be sure that in my statement on the floor at the time that we discuss the enterprise zone bill, I put particular emphasis on these points that you make so that the Department of Housing and Urban Development will look to the legislative intent.

Ms. Howard. Well, Senator, also, may I just put in another plug. The reason the child care wasn't in there, it was just strictly a typographical error. It was discussed in committee.

Senator Boschwitz. We're not going to get that, Sally.

Ms. Howard. OK. But just let me go on record in telling you why we thought it was so important. If you look at a true dilapidated area that has nobody there other than some residential, perhaps, but no jobs and no commercial district, you're going to find a very high percentage of single heads of household who are going to be that work force that we are so anxious to get back into the marketplace. The only way successfully they can do that is with child care reasonably priced and in the neighborhood because, obviously, these same folks are not going to have cars. You know, I just—I know it's a component, but if it's missing in the mass of help and in an enterprise zone like in Detroit or East St. Louis, that you're building in some failure because the very people you want to put to work can't do it.

Senator Boschwitz. Well, let me note that we're not the only people who can provide child care. The Federal Government, the city of Minneapolis, maybe want to take it upon itself and make it a part of its application that they're going to put up in the midst of this zone a child care clinic.

Ms. Howard. That's fine with me as long as it's—as long as HUD says that's one of the things you ought to look at, city of Minneapolis, city of East St. Louis, as you set up your enterprise zone, so that they're cognizant of the fact that that's a component that ought not to be missing.

Senator Boschwitz. Put it in your application and maybe it will stand out in that case. We learn to rely upon local imagination and not seek regulations that specify every element that should be in these zones. We want to get these regulations done and out.

[Whereupon a discussion was held off the record.]

Senator Boschwitz. There's nothing in the bill, as you know, about the timeframe to the issuance of regulations. My staff says that we've been talking about them issuing regulations in 60 days. If they achieve that, it will be close to a miracle. But we'll push them along because we want to get the darn thing started, and it's important that they not try to define every aspect of it but allow the creativity of Minneapolis and so forth.

Ms. HOWARD. I just want to raise some consciousness.

Senator BOSCHWITZ. Yes. Put it in your application. Tell them you got right in the middle of it, the city of Minneapolis is going to have a child care center and you're going to spend a little money. It will make your application stand out.

Ms. HOWARD. All right. Thank you, Senator Boschwitz.

Senator BOSCHWITZ. Thank you very much for coming, Sally, and I appreciate your testimony. Our next witness may not be here. In that event we'll just—we'll skip him and come back to him later on. But is Mr. Gene Wright of Northside Automatics here?

[No response.]

Senator BOSCHWITZ. Then we'll go to Dick Atwood of Durkee-Atwood Co.

STATEMENT OF RICHARD W. ATWOOD, PRESIDENT, DURKEE-ATWOOD CO., MINNEAPOLIS, MINN.

Mr. ATWOOD. I have a prepared statement and a number of copies for distribution if you would like.

Senator Boschwitz, I appreciate the opportunity to be here today and share some of my observations with you. I'd like to preface my remarks with a little bit about Durkee-Atwood. We are a basic industry in what we would call a concentrated spectrum of industries. We're a midsize business, and many people today have said, "Gee, being a midsize business is rather tough. Nobody pays much attention to you. They pay their attention to the small business and the large corporation." We find our size very comfortable and getting much better.

Senator BOSCHWITZ. What does, "midsize" mean? I want to see if I'm midsize, small.

Mr. ATWOOD. They can't define that. They're having a tough enough time trying to define small business.

Senator BOSCHWITZ. I know.

Mr. ATWOOD. And I would say midsize in a concentrated industry is the No. 4, 5, or 6 producer in total revenues within that industry.

Durkee-Atwood is, as I said, is a basic producer. We're invisible. We produce power transmission, industrial and automotive rubber products, and cellular products. We have a partially owned subsidiary which is truly a small business. It's autonomous and it produces sealers, adhesives, and mastic products and also some processing chemicals for our firm.

In reading about this legislation, I would like to start out that over the past several decades public emphasis in the urban areas has been on housing. And housing has been subsidized and this has been a funding drain. Now, as we try to reverse this trend, we from specific experience are running into opposition, very, very extreme opposition from the local neighborhoods. And I can't find fault with them. They've been educated that housing is the thing and that's the American dream, and we all concur with that. But there's also another American dream, and that's jobs. As a result, nobody wants a basic industry such as ours in their backyard because that has a tendency to depreciate the value of their real estate. We've also run into what we call political action groups, which I guess I'm not sophisticated enough to have known the power that these groups have. They are appointed and they are controlling the funding that is allocated for these various developments in many instances.

What I'd like to explain briefly is the Durkee-Atwood case history. Durkee-Atwood announced earlier this year an expansion program. Many people have said, "How can you be expanding in a down economy?" And my answer is that we've been preparing this for many years and we have a large volume of our business which is associated with replacement parts. As people run their equipment, their automobiles, their appliances, their machines longer, of course, the parts business goes up, the replacement market. We announced in Red Wing, Minn.—we operate in Red Wing and Minneapolis—a $4.3 million expansion to double the capacity of our basic rubber mixing mill and fabrication plant; $3 million of this is to be financed by industrial revenue bonds. However, with the large maze of—of regulations that we are confronted with today, I'm sorry to say we have not marketed the bonds yet. We are under construction, however. The——

Senator BOSCHWITZ. May I ask you, what is a rubber mixing mill?

Mr. ATWOOD. Well, a rubber mixing mill consists of ponderous equipment, a large internal mixer, requiring tanks for oil and silos for carbon black and storage for many processing chemicals. And it was considered, of course, in the old days when they fed the mixers by hand, as a very dirty business. Carbon black migrates. It sifts everyplace. Realizing this, in 1973 we dedicated a new mixing plant in Red Wing which has bulk material handling equipment, requiring considerable capital investment. It's self-contained and it takes the dirt out of the environment and out of the workplace, which is to the benefit and health of workers and the community.

Senator BOSCHWITZ. Pardon me, Dick. I may have missed it, but would you describe more fully exactly the products that Durkee-Atwood produces.

Mr. ATWOOD. Well, they're power transmission belts, categorized as V-belts and synchronous belts, variable speed belts, and they go all the way from small business machines up to huge belts that drive oil pumps for the energy industry, drive oil exploration rigs, and drive the giant crushers on the taconite range. They're just used everyplace. In your home they're all over your appliances, your lawn and garden equipment. Then our second line is sponge rubber products which we are one of a few basic complete line producers. And then we have a line of accessory products such as pulleys. We sell drive systems. When we engineer a drive for a manufacturer, for example, we would—we would engineer a complete drive system for them. It's associated with mechanical engineering. It's mechanical powered transmission. It's associated with the power transmission and bearing industry.

Senator BOSCHWITZ. Let me ask another question. Was this a picture of your——

Mr. ATWOOD. Well, let me get into that.

Senator BOSCHWITZ. Oh. Pardon me. I saw it put down.

Mr. Atwood. That's the second part. I explained this is a two-part expansion program.

The $4.3 million program in Red Wing was, of course, met with enthusiasm. They couldn't wait to approve it. As one of the council people down there remarked, "This is truly what the Industrial Revenue Bond Act was for." It was devised for an incentive to industry to supply blue-collar jobs. And maybe that's discrimination, but that was the purpose of the act, and we know what's happened to the law ever since. It's been used for everything including housing, which doesn't in the long term create employment.

The second part of our program was to take our old corporate headquarters building, which we have an architect's version of, and with a balanced architectural scheme, make industry compatible with the residences, with the commercial establishments, to modernize the building, bring it up to a better operating condition and put with it a high technology fabrication plant. We call this our high technology type of power transmission products. There's no rubber mixing mill here, so the neighbors don't have to worry about migration of carbon black.

Senator Boschwitz. Where is that?

Mr. Atwood. Northeast Minneapolis. The problem we have run into is because Government has promoted housing to such an extent that we have had violent opposition to this plan from the local neighborhood group. And I'm not criticizing them. I guess if I had been pushed in this direction I would do the same thing. What I'm proposing is that I think that we can have a balance of a neighborhood concept of modern basic industry, subsidized housing, low-rent housing, senior citizen housing, private housing, and this is certainly exemplified in the Graco development which is in our part of the city, and I won't go into detail on that.

The enterprise zone as I see it would be the catalyst, but a second part of this would be the midsized company, the basic industry. Now, a basic industry does this: We have many vendors of supplies, tools, parts, advertising, services that feed their product into us. And then on the supply side we have many distributors, thousands of distributors who are independent small businessmen, and these are mainly small business people. Small businessmen that would not exist if they didn't have a viable supplier such as our company. If it's all controlled by two big companies, you know what happens. You would go to vertical integration of business and the small guy would get frozen out. So this is——

Senator Boschwitz. The price would go up.

Mr. Atwood. So this is why I say that midsize basic industry is the catalysts behind this legislative concept.

Now, the other part of it is educating the people. I think our emphasis has to be, from my experience, and I'm only saying this from my experience, so that it might assist us in doing this job later on, is to educate the people, reeducate them that industry is good and jobs are good. And I am suggesting that we put some emphasis into this area.

Now, tax incentives are good. I like the tax incentives that you've applied to this. They offset the problem that small business is having today in capital formation. We know what the problem is, to try to equity finance today. If you're a generally unknown midsize business confronted with double taxation of dividends, you don't attract many investors. And with the huge deficits that State and Federal Governments are building today, of course, the forecasts are for interest rates up here, so the debt mark——

Senator BOSCHWITZ. We took care of that last night. Rather late, too. [Laughter.] Pardon me.

Mr. ATWOOD. Well, let me go to the other part of an observation that I would like to make. I've been a proponent of this for many years, but I would like to suggest that we revise the Internal Revenue Code to a flat tax rate and I will give you my reasons for doing that. A flat tax rate could be progressive. You could exclude $6,000 or $8,000 of income for everybody so the low wage earners wouldn't be hurt, would not be taxed, then after that you tax everybody at 19 to 20 percent and you forget about all the complications that we have today in trying to figure tax returns. Plus all of the abuses in the Tax Code, the number of people that don't pay taxes. And, of course, the underground income which is a great loss of revenue. This would release the IRS to go out and collect the taxes from the people that choose not to pay. I think it would help to cut down the regulatory costs that we have today and balance the Federal budget. Here we're creating a whole new spectrum of tax incentives, a new set of regulations which we don't need. I don't have enough time to understand them anymore. We will create a new bureaucracy, and just like industrial revenue bonds, if I may say so, it will be subject to abuses. Because we have a lot of smart people around and they will find ways to abuse the law. A flat tax rate would eliminate this.

My suggestion is that instead of going to a whole new system of business tax incentives, we eliminate the current disincentives to business and then we work on a strong program, a conservative program for business, local government, citizens, State government, Federal Government to work together in concert and really return business to the free enterprise system.

We have not asked anything from the city of Minneapolis. When I appeared before the city council, the caucus of the city council, they said: "What do you want from us? UDAG? Tax increment financing?" I said: "We don't want anything." You don't get something for nothing. We just want the chance to improve our building and our real estate and a chance to operate. I don't think we're going to get that chance. I am presenting this case history because I think it is very important. I think the neighborhood concept is important. The Japanese have used it very successfully because you make money today by inventory management, and they have all their satellite suppliers right there in a cell around a basic automotive assembly plants, for example. And you can just visualize the transportation time and expense that is cut down, plus the lack of, or the nonnecessity of carrying extra inventories which require working capital.

Thank you for the opportunity to present my statement.

[The prepared statement of Mr. Atwood follows:]

Senate Small Business Committee Hearing May 7, 1982
ENTERPRISE ZONE ACT OF 1982

Testimony presented by Richard W. Atwood, President-Durkee-Atwood Company

Durkee-Atwood Company is a major basic producer of fabricated rubber products including mechanical power transmission belts, cellular sponge rubber, automotive and appliance hose, and sealant-adhesive products produced by a subsidiary, Diversified Specialties, Inc. Our products serve industrial, original equipment, transportation, hardware and construction trades. Markets are served through ten branch warehouses located in major metropolitan areas and independent distributors concentrating in specialized markets to user trades. Operating divisions include Durkee-Atwood, Permatite, Insure and Auto King trade names. Our products are marketed internationally through Durkee-Atwood Limited, a DISC corporation.

Diversified Specialties, Incorporaated, operates as an autonomous partially owned subsidiary of Durkee-Atwood. As an innovative small business, Diversified Specialties manufactures sealants, adhesives, tapes and mastic products marketing its output through Durkee-Atwood's national distribution and sales system.

The enterprise zone concept utilizes the private sector to create a free market environment in economically depressed areas by

1) Reducing taxes
2) Reducing government regulations
3) Reducing other government burdens at state and local levels

For the past two decades inner city growth in our metropolitan area has emphasized service organizations, recreational enterprises and subsidized housing consisting principally of high and low income condominiums and apartments. Through powers of eminent domain, local public authorities assisted by the promotion of politicians and developers have relocated basic industry into suburban and outlying areas creating community imbalance. Today our freeway networks are cluttered with severe traffic problems whereby the professional and clerical commuter is journeying from the suburbs to the central city, and conversely, the hourly and skilled trades employee from the central city to the suburbs. Inner city enterprise zones can assist in restoring balance whereby jobs become available within the residential community. An added benefit might be the generation of a prosperous working class to support sport teams which currently occupy a new dome structure financed through tax revenues.

Problems our company has experienced in trying to expand in a redevelopment area could be enumerated as follows:

1. Local PAC neighborhood groups controlling and allocating funding. Their involvement and acceptance of industry in their neighborhood is key.

2. Prior low interest subsidized loans used to finance upgrading of old housing. Individuals are sensitive to industrial development which might depreciate the value of their real estate.

3. Low income occupancy by non-producing individuals and senior citizens. Tendency, which is understandable, is for these individuals to object to industrial activity in the neighborhood.

4. For the past two decades government emphasis has been principally on subsidized housing at the expense of relocating depreciated basic industry. Now we must reverse the position and tell the home owner that he must accept basic industry after years of educating him to the contrary.

5. Relocation and restructure of basic job skills. A metropolitan area can't exist on high technology electronic industries alone.

6. Local grass root opposition to industry even when no subsidies are requested at federal, state and local levels.

We believe the following benefits through job creation would overcome the past dependence on government funding which is non-productive:

1. Reduction of federalism and return of the decision making process to the local community.

2. Create incentives for housing and industry through balanced funding projects.

3. Promotion of small and diversified businesses creating new jobs.

4. Enhance capital formation for new enterprises. We would recommend greater latitude whereby the corporation could invest a percentage of its pension fund assets in its own business reducing the restrictive policies of ERISA.

5. Incentive for private sector capital investment with opportunity for reasonable return on investment would reduce cost to government at all levels.

6. Revival of small private companies creating more individualism and reducing past trends of mergers and acquisitions resulting from burdensome tax laws and lack of financial incentives.

7. Reduce the large corporate concept and concentration of industry which has tended to lessen competition.

8. Past inflation created the necessity of dual income families. Enterprise zones would create jobs in neighborhoods allowing housewife members easy access, reduced transportation time and opportunity to run the household in conjunction with full time employment. The collateral benefit would be the opportunity for part time employment as well.

9. Federal, state and local government tax simplification which threatens to become even a greater burden on individuals and businesses in the future.

10. Ability to create supporting small business enterprises if a moderate basic industry can prosper in a neighborhood area. Independent sub-suppliers in the same locale reduce inventory lead times improving inventory management for greater earning strength enabling basic domestic industry to be competitive in world markets.

11. Expansion of foreign trade opportunities which will enable our country to create a favorable foreign exchange balance.

The Durkee-Atwood Company as a result of its new private corporate structure has proposed a development project to upgrade, modernize and expand its inner city factory creating a balanced environment within the neighborhood known as Northeast Minneapolis. This has become a part of the St. Anthony Development Project which for the past two decades has been funding housing, recreational and retail establishments and also successfully stopped the I-335 freeway project as a result of an environmental impact suit conducted by a local citizens group. The directors of the Durkee-Atwood Company in its new corporate structure are dedicated to the basic principles that they have a duty not only to the shareholders, but also to the well-being of the employees of the company as a whole and to the communities in which we operate.

Our development proposal submitted to the Minneapolis Community Development Agency includes an expansion of our corporate headquarters to include a high technology belt fabricating plant maintaining and creating clerical, professional and salaried occupations as well as hourly skilled and semi-skilled jobs. Two Hundred people will be employed at all levels of the proposed rubber fabricating operation. The architectural and mechanical design including upgrading and modernization of our existing structure is compatible with the local neighborhood atmosphere including green belt buffers and off street parking. The plan is a community blend of a beneficial industrial operation combined with landscaped areas, commercial establishments, subsidized dwellings and private investment housing. The concept is a return to the neighborhood community for revitalization of major metropolitan areas which was the basis of our country's economy at the turn of the century.

In our promotion of this development strong opposition has been voiced through a neighborhood control group known as the I-335 Committee. Their opposition is understandable since they successfully stopped the freeway project through their neighborhood. Assuming their homes are their major individual investments, relocation of industry which is converse to the housing promotions that have been encouraged, becomes a very sensitive issue. Along the way our company has been unjustly subjected to adverse publicity portraying it as a dirty rubber operation promoted through community meetings and in the media. Subsequently, our company fully aware of the necessity to modernize and our inability to obtain expansion space at our Minneapolis plant locations, constructed a modern rubber mixing mill complete with internal bulk material handling systems which meet tough Minnesota imposed environmental and employee health standards. This new facility also included additional finished product fabrication capacity needed for expansion. Through lack of information and the bad image that had been created for basic industry as essentially selfish and not sensitive to employees and communities, this project was construed as an attempt by the company to move its entire operation out of the city of Minneapolis. This decision which was made by poorly informed individuals was unfortunately communicated through the media and was absolutely unfounded. On the contrary, our new corporate directors are dedicated to remain in the metropolitan trading area provided we are not subjected to further delays that might jeopardize the company financially and reduce the security of our employees.

When I became involved in the industrial rubber products industry some 25 years ago we had 14 domestic competitors. As the trend of consolidation and concentration continued during this period, we presently have four national complete line producers of which Durkee-Atwood is one, and two short line firms left in our domestic market. Durkee-Atwood, however, is a mid-size firm considered small business in a concentrated industry, with far less financial resources than our major rubber industry's competitors who produce tires and automotive rubber products. We submit that a mid-size firm, even in a concentrated industry, exhibits power through its ability to compete and additionally has greater concern for the health and personal satisfaction of its employees as well as the communities in which it operates. A mid-size firm also promotes small satellite industry through supporting vendors of services, supplies, machine shop tooling, printing, advertising, auditing, machine tools, in addition to promoting small business at the distribution level in selling its produce line. We are allied members of the Power Transmission Distributors Association, Mill Supply Distributors Association, and Automotive Services Industries Association, which consist principally of distributors dominated by small businessmen. Without viable suppliers of quality merchandise these small business marketing innovators would not be able to survive. Competitive incentive would be reduced and basic industry would succumb to aggressive foreign competition.

Our present neighborhood community contains firms that have received federal UDAG grants. Northeast Minneapolis has the Graco development which is testimony to the concept that industry and moderate to high priced private housing can exist compatibly. We believe that tax subsidies provided by enterprise zones are justified considering the problems of capital formation in the private sector. Double taxation of dividends and government imposed risk factors through regulations have reduced the private corporation's ability to equity finance. Interest rates are excessively high, and industrial revenue bond tax-free regulations are threatened through abuses created by local government approval of questionnable projects. Industry must compete for funds with huge government deficits and a balanced budget at the federal government level is essential. Waste and inefficiency must be eliminated and indexing through the Consumer Price Index, which is inflationary in its own right by providing cost-of-living escalators to employees and Social Security recipients, must be restructured. The enormous difficulty to understand ERISA regulations has defeated defined benefit pension plans for small and moderate size industry. Enterprise zone tax subsidies can have the effect of reversing this imbalance helping to create financial health for industry and individuals.

We are in concurrence with the complete neighborhood development concept which includes housing, commercial, recreational and industrial promotion rather than giving priority to one element such as housing alone. Enterprise zones will be one of many contributing influences in achieving this goal. To be successful, however, individuals through the private sector and political process must cooperate rather than allow special interest adversarial relationships to prevail. If this teamwork philosophy can be achieved utilizing the enterprise zone as the catalyst, we will move from a program of draining government funding and increased taxation to replenishment and acceleration of funding provided by the private and public sectors through greater individual earning power. The result is the compounding of money through the non-inflationary productivity process of creating real income and employee benefits which in turn will expand bank deposits, credit and retail sales for expansion of our economy on a sensible basis.

Respectfully submitted,

R. W. Atwood

R. W. Atwood

ENTERPRISE ZONE ACT OF 1982

Supplement to Testimony Presented by
Richard W. Atwood, President, Durkee-Atwood Company, manufacturers
215 N. E. 7th Street, Minneapolis, Mn. 55413

Before Subcommittee on May 7, 1982
Senate Small Business Committee

With due consideration to the work, spirit and creative thought that has gone into the enterprise zone balanced neighborhood concept, I respectfully submit an alternative solution for consideration by the United States Senate Committee on Small Business, Lowell Weicker, Jr., Connecticut, Chairman.

Let me preface my remarks by stating that I am in favor of enterprise zones which are promoted by the private sector in cooperation and harmony with local and state governmental units. We must, however, consider the underlying fact that enterprise zones will create new laws which will add to the cost of doing business through burdensome regulations and bureaucracies. Certainly these regulations will in time be challenged by the Department of the Treasury, the Internal Revenue Service, and state and local government taxing authorities including regulating agencies. As a result of the inequities of the current tax code, which are defeating capital formation through equity financing by double taxing dividends and debt financing through high interest rates caused by the Treasury's inability to balance the budget, the Enterprise Zone Act proposes to offset these constraints to economic expansion by creating a new set of tax incentives which will further complicate and increase the cost of doing business.

In the alternative I would urge a flat tax rate on personal and corporate income designed to balance the federal budget in 1983. This is not a new concept and was proposed by Treasury Secretary William Simon in 1976. Elements of progressivity could be built in without defeating the purpose of the tax. Possibly a 19% flat tax rate, for example, would balance the 1983 budget while allowing the first $6,000 of income to be excluded from tax. The exclusion would eliminate moderate and low income wage earners from current oppressive tax rates and complicated filing procedures. Collateral benefits would be elimination of bracket creep, tax indexing, high interest rates through a balanced budget, capital shortages, marriage penalties and penalties for success which deter initiative. Such a flat tax rate could bring an end to the underground economy and provide improvements in economic efficiency that would result from eliminating the numerous inequities in the current tax code. Individuals would be able to quickly and easily prepare their own income tax forms. Even Tip O'Neil would have to agree privately that this could be the solution to the current budget deficit stalemate in Congress.

If a flat tax rate were adopted we could release government energies to assist the private sector in establishing enterprise zones through promotional activity without having to enter into a new set of regulations providing corporate and personal tax subsidies that will surely be subject to abuse at a later date, similiar to industrial revenue bond financing which has been construed to multiple uses beyond the original intent of that legislation.

Enterprise zones and mid-size basic industries will serve as the catalysts. Small businesses in all categories will form to serve the core industry, and discouraged workers through personal contact offered by management of small and mid-size business can be educated on the intrinsic value of pride in their work and their individual contribution to real productivity. Wages alone will not encourage skeptical workers, who are used to a welfare system, to return to the production system which will produce real income. Promotion emphasizing pride of work and accomplishment will provide the necessary incentive for people to once again become gainfully employed.

Elimination of complicated regulations rather than adding to, will enable us to revitalize the American economy at the local level. It will revitalize small business and individual initiative which after all is the base of real economic success.

Respectfully submitted,

R. W. Atwood

Richard W. Atwood

Approved by IGR
Committee, 5/4/82

MINNEAPOLIS POLICY POSITION ON URBAN ENTERPRISE ZONES

The proposals for "Urban Enterprise Zones" advanced by the Administration and by the Kemp-Garcia/Boschwitz-Chaffee bills represent a significantly different approach to urban revitalization than previous Federal programs.

The City of Minneapolis has analyzed these proposals carefully to determine their potential for addressing City problems and assisting its revitalization efforts.

As currently proposed, Urban Enterprise Zones appear directed primarily toward the kinds of urban problems faced in some older, very severely distressed urban areas. These are areas with such problems as:

- widespread abandonment of structures
- almost complete absence of new private investment
- pervasive tax delinquency
- very high unemployment
- substandard levels of public services
- minimal public capital investment and deteriorated public facilities.

The selection criteria for Urban Enterprise Zones would permit some areas of Minneapolis to qualify--certainly the Near-North (Grant) area, and parts of the Phillips/Seward areas. None of these areas, however, display more than isolated examples of the types of problems summarized above. Applying Urban Enterprise Zones effectively in Minneapolis is, therefor, not simply a matter of easing criteria to make the City eligible.

The City's areas needing revitalization, as on the Near South and North sides, evidence problems that are of major concern to the City, and are sufficiently serious to qualify the City as a whole under UDAG distress criteria (which are also the criteria for Urban Enterprise Zones). These problems, however, are of a different character than those cited above. They include:

- pockets of neighborhood blight and deterioration that threaten wider residential instability
- insufficient standard housing for low-income persons
- declining neighborhood commercial areas no longer competitive or providing adequate services and jobs
- inability to retain existing job-intensive indusdustries needing space to expand

Urban Enterprise Zones as proposed offer incentives that may be useful in areas where problems have become so severe that none of the traditional forms of public assistance can succeed without prohibitive costs. These incentives emphasize major tax and regulatory relief for private firms on a scale designed to encourage their location and expansion in an Enterprise Zone, such as:

- investment tax credits
- relief from income and capital gains taxes
- accelerated depreciation allowances
- tax credits for hiring Enterprise Zone residents, and income tax credits for Zone employees
- relief from Federal regulations

Cities and states are expected to supplement these Federal incentives with such commitments as:

- property tax abatement, if permitted under State law
- relaxation of zoning, licensing, permits, and codes
- capital investment in public facilities
- increased levels of services, with particular emphasis on using private and voluntary service delivery for greater efficiency and economy

(Although the precise mix of state and local incentives is a matter of state and local discretion, the Federal government will award the limited number of Enterprise Zones to be designated on the basis of how large an incentive package is offered. The effect will be to "bid up" the state and local commitments.)

In comparing proposed Urban Enterprise Zones incentives with the City's needs, major questions arise as to how effective they will be. Specifically:

- Experience in such areas as Grant, North Washington, and Seward Southeast shows that industrial firms are willing to locate or remain in the City, provided they can find adequate sites at a competitive price. The incentives provided in Enterprise Zone proposals are useful here only to the extent needed to offset land costs sufficiently to make inner-City sites competitive with suburban sites. Tax incentives alone cannot address the problems of providing adequate sites.

- Industrial firms are concerned, in choosing an inner-city site, with the quality of an area's environment. The Enterprise Zone proposals assume that cities have not invested in improved facilities and blight elimination, and would include this as part of their local contribution to Zone incentive package. Minneapolis, however, has already made major capital investments over many years in inner-city industrial districts and neighborhoods, and hence cannot compete for Zone designation on this basis.

- The City has also committed major resources to housing development for low- and moderate-income persons, and for neighborhood revitalization. Federal Enterprise Zone incentives, designed for severely blighted or abandoned slum areas, could produce serious disruption to the neighborhood stability the City has worked hard to foster. Zones could either encourage unregulated industrial and commercial development in or near residential areas, or foster rapid speculative increase in rental housing costs--appropriate to attract investment to an abandoned area, but not to neighborhoods where affordable standard housing is already in short supply.

- The City has been less effective in fostering neighborhood commercial revitalization in areas such as Franklin Avenue. The risks of commercial development are so high and returns so low, as to require very major public subsidies for even modest redevelopment. The Enterprise Zone incentives, however, do not address the primary needs of small businesses in such areas. Tax relief on income and capital gains, for example, means little for struggling, marginally profitable firms. The primary need of small business is venture capital and credit at far lower than current market rates.

- The City has also had less success in improving job opportunities for its low-skill, under-employed population (in part, because job expansion in Minneapolis lies primarily in office, technical, and service-type firms with high-skill requirements). It is uncertain whether the tax credits proposed in Enterprise Zones for hiring of zone residents provide sufficient incentives (particularly for smaller firms) to offset the costs of training and low productivity incurred with low-skill employees.

- State and City regulations in Minneapolis do not appear to be a significant barrier to investment and business development. At the same time, efforts to "bid up" the competitiveness of an Enterprise Zone proposal could lead to regulatory concessions whose costs to the City's quality of life outweighed the benefits of increased economic development.

In summary, there does not appear to be a very close match between the City's revitalization needs and the impact of Urban Enterprise Zones as proposed.

The problem is not one of adjusting the Enterprise Zone legislation to increase the City's chances to compete for Zone designation. It is a more basic problem of proposed Zone incentives not addressing obstacles to Minneapolis development.

The City believes that it is not unique in this respect. Many other cities of its age, size, and characteristics face the same kinds of problems, and hence difficulty in matching Urban Enterprise Zones as proposed to their needs.

The City supports the Enterprise Zone concept in the form advanced as an experimental program for those few cities with the very severe problems of blight and disinvestment for which the program seems best suited. It urges that the criteria for designation of zones to receive the full incentive package proposed be made more restrictive, to assure that those cities most severely in need will benefit.

The City further urges that a second category of Enterprise Zone be added to the legislation now under consideration.

This category should be accessible to a larger number of cities that require greater flexibility in matching an Enterprise Zone approach to their specific local needs. These are cities where some assistance is needed to reverse trends in declining but not devastatingly blighted areas--in order to forestall the need for much more costly public incentives and assistance in future years.

This second category of Zones would involve fewer Federal incentives--only such as would assist small business needs and offset costs of hiring and training underemployed persons. These could be limited to:

- Investment Debenture Tax Credits, which would provide tax credits to individual or institutional investors in small businesses to encourage provision of venture capital.

- A non-refundable employer tax credit for payroll paid to area employees in excess of payroll paid to area employees the the year before area designation.

- An employer tax credit for wages paid to disadvantaged individuals hired after area designation of 50 percent of wages for the first three years, declining 10 percent per year thereafter.

- Permitting small business to carry over operating losses for the life of the area or 15 years, whichever is longer, to charge for tax purposes against profitable years as desired.

The second category of Enterprise Zones would permit greater State and local initiatives in assisting business development and Zone revitalization. The administering Federal agency (presumably, HUD) would accept any Zone in which State and local governments had agreed on commitments to provide incentives and assistance to the Zone.

States would establish standards for eligible distressed cities. Most beneficial to the City would be a standard permitting designation of an entire municipality as a Zone. Barring this, cities should be permitted to have several Zones. Designated cities could together total no more than 25 percent of a state's population. The state/local commitments would have to include a minimum number of the following (or similar) forms of assistance:

- A small business support group to provide such services as banking relations, tax consulting, accounting assistance, risk management, compensation planning, legal and patent counsel, labor relations, and business planning.
- A Venture Finance Pool capable of financing small amounts (down to $10,000).
- Regulatory relief such as one-stop service for all state and local permits and approvals.
- Packaging of below-market rate lending assistance from Federal, state, and local programs to small businesses in an area.
- Security devices for real estate loans to small businesses.
- Assistance in overcoming inherent financial problems in small business operations, such as unavailability of insurance.
- Prevocational and skill training for the unemployed and underemployed, and child care to permit unemployed parents to secure work.
- Neighborhood crime prevention programs.
- Tax-increment and other financing assistance for development.

Senator BOSCHWITZ. You say that it doesn't appear that you're going to be successful in doing to this plant—this is both the plant and office?

Mr. ATWOOD. Yes. It would employ 200 people.

Senator BOSCHWITZ. Additional people?

Mr. ATWOOD. No.

Senator BOSCHWITZ. Pardon me?

Mr. ATWOOD. Total, including clerical, professional, salaried, and hourly.

Senator BOSCHWITZ. And that's an increase over the existing level?

Mr. ATWOOD. That's our minimum. We expect to increase that. There is no longer a mill there. We put the mill in Red Wing. And it's a misunderstanding. I'm not criticizing anybody. We are misunderstood as a dirty industry, like a foundry or like an asphalt plant, and, I guess, I would be subject to criticism. We have not promoted ourselves properly. What I'm saying is we have to get a better understanding of industry with people and then we have to go out and sell the people and through small business and midsize business, we can do that. I can talk to our employees and we can induce pride into their jobs. Wages alone wouldn't do it. We saw what happened in Detroit. If a person knows that his job is important, if he's on a machine, I don't care what he's doing, he or she, they'll go to work for you. And we can get these people—a further drain on our funding—we can get these people off unemployment compensation and off the welfare rolls, which as we all know, are a disaster. We have disincentives to work built into our social systems today. So, what I'm calling for is a more radical approach and let's get this back to the base neighborhood where we can control it at grassroots, and let's give businessmen bipartisan support. Businessmen and local officials together with union people, salary people, let's all understand it a little better.

Senator BOSCHWITZ. I like your proposal with respect to a flat tax rate, which is kind of an adjunct to the rest of your testimony. We have included your testimony in its entirety, as you presented it, as part of the record. The idea of a flat tax rate is very appealing. It probably could mean that the top tax rates are in the area of 14 to 16 percent. It would undoubtedly meet with considerable opposition. One of the reasons I have supported the Tax Recovery Act that we passed last year is the fact that it brought top rates down from 70 to 50 percent. And, hopefully, over the years we can continue to bring that rate down and not put new advantages or leverages or deductions or credits or other things into the tax law, because as you say, those things really turn out to be accountant and lawyer relief bills. My tax return was about 70 pages long this year, and it realy is difficult to cope with and extraordinarily expensive. That money and those funds are really nonproductive.

And I agree that it's done quite aptly and quite efficiently in Japan where they take a different viewpoint. I'm not sure that in our country we would quite approve of the lockstep type of arrangement that there exists between the government and industry, particularly, and even some degree, labor. We have more of an almost adversary relationship between government and business, which is bad, but to some degree it's quite proper that they are separate interest points and should not be of cross purposes, but certainly, should be balanced between one another.

We thank you, Mr. Atwood. We hope that your—your plans for northeast Minneapolis—northeast, you said?

Mr. ATWOOD. Northeast. Yes, sir.

Senator BOSCHWITZ. Northeast Minneapolis will come to fruition. I'm very familiar with Graco and they certainly have done nice things in that part of town and at least from the looks of it, you intend to do the same. And I hope that you will find a way to achieve those things. We've appreciated your correspondence and we've also appreciated your testimony here this morning.

Mr. ATWOOD. Thank you.

Senator BOSCHWITZ. We're going to take a short recess and then we will resume the hearing.

[Recess.]

Senator BOSCHWITZ. We will call our next witnesses; Mr. Jack LaVoy for the city of Duluth and Nick Smith for the city of Duluth. If you gentlemen will come forward. We welcome both of you.

Recently, I read an interesting article in the Wall Street Journal on May 3 about the United Coatings, Inc., which is a paint and solvent manufacturer, probably encountered some of the difficulties that Mr. Atwood was talking about. But he locates in the inner city. He likes old buildings. He likes the economies that occur in old buildings. And his headquarter buildings, he points out, cost him $400,000, and the competitor has recently opened a brandnew plant in a suburb that costs $9 million. With a cost of supporting that kind of an investment today, he certainly feels he has an advantage, even though he produces somewhat less paint per hour than his competitor. So, that some people, some businesses, apparently, continue to feel that there are some savings to be made by not following the stampede or the trend to go toward the suburbs where life certainly is a little bit easier, walking—perhaps, even obtaining employees is easier, but the opportunities continue to exist in the cities.

And we're pleased to have you here this morning, Mr. Smith and Mr. LaVoy, to tell us about Duluth and some of the thoughts you have with respect to this bill.

STATEMENT OF NICK SMITH, ATTORNEY AT LAW, CITY OF DULUTH, DULUTH, MINN.

Mr. SMITH. Thank you, Senator. I would like to clarify our respective positions. I'm a private citizen appearing on my own behalf, and Mr. LaVoy is appearing on behalf of the mayor of the city. I've been asked by some business people in Duluth to come down and talk this morning.

I am a private lawyer residing and practicing in the city of Duluth and in that capacity I've represented for over 20 years small and very small businesses. My principal activity is assisting these small businesses in getting established financially and assisting them with their financing needs as they grow. I live in a community, as you know, which has been very hard hit by the loss of a U.S. Air Force Base and several major employers who have through sale or choice moved to other areas of the United States to do business. I am very excited at the prospect of enterprise zone designation for our community. My understanding is that philosophically the bill is designed to encourage new economic activity in distressed neighborhoods through Federal income tax incentives to employers and employees, relaxation of Federal, State, and local regulatory burdens, and special local assistance in a variety of traditional and nontraditional ways.

The incentives included and contemplated by the bill are important and are beneficial to small businesses. I believe, however, that the incentives could be significantly enhanced by directly addressing the major problem facing most entrepreneurs trying to start up or expand their businesses; namely, the need for equity capital. Very few small businesses have sufficient track records to obtain startup or expansion capital from lenders, and very few have sufficient glamor to attract the risk takers or venture capitalists to provide them with seed money.

It seems to me that the effectiveness of the enterprise zone legislation could be dramatically enhanced by including a feature which offers an unusual incentive to encourage small investors to take risks and back entrepreneurs wishing to do business within the enterprise zone. Specifically, I would urge that a provision be added to the bill which would provide a current Federal income tax deduction to an investor willing to make an equity investment in a small enterprise zone company. I firmly believe that such a provision would have the effect of encouraging the doctors, lawyers, accountants, merchants, and other residents of an enterprise zone community, who would like to make an investment in their community but are afraid of the risks of investments in small businesses, to invest in enterprise zone companies and help in the creation of jobs in the communities in which they live.

Senator BOSCHWITZ. Let me comment for just a moment. Pardon me for interrupting your testimony. I think that this point is very, very well made. I fully expect that there will be amendments offered on the floor. You're talking about a deduction rather than a credit, more specifically?

Mr. SMITH. Well, that's my specific suggestion, and a credit would certainly—I think it could be done either way.

Senator BOSCHWITZ. I'm sure that this will come up on the floor. Frankly, in order to get the Reagan administration to concur, we had to get the approval of the Department of Treasury, and they simply wouldn't go for that. Again, as I mentioned earlier to one of the witnesses, they're very jealous of their revenues and don't want to forgo any of it. And if you say: Well, this is just a little bit, then they say they're going to be nickeled and dimed to death. You know that whole story.

Pardon me for interrupting your very interesting testimony.

Mr. SMITH. Yes, sir.

I and others are presently in the preliminary stages of seeking to form a capital pool in Duluth designed to invest in or buy companies which can provide new jobs for our community. If the investors in the pool knew that they could get a current tax deduction for all or part of their investment to the extent their moneys were

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invested directly in enterprise zone companies, our job would be significantly less difficult.

The idea of allowing current income tax deductions for very high risk investments consistent with national policy, is certainly not new. Mineral exploration activity has been thus encouraged for many years. In the event the business is successful and the investment is later disposed of, taxes would be paid in the usual fashion. Section 1244 of the Internal Revenue Code can be rather easily amended to effect this proposal. The key, I believe, is to provide a current tax incentive for making the investment to begin with.

Such a direct approach to stimulating investments in small businesses is a cost efficient and immediate approach to economic revitalization, and is fully consistent, I believe, with the philosophy of this legislation.

[The prepared statement of Mr. Smith follows:]

TESTIMONY OF NICK SMITH
700 Lonsdale Building
Duluth, Minnesota 55802

May 7, 1982

Re: S.2298; Entitled "The Enterprise Zone Tax Act of 1982"

I am a private lawyer residing and practicing in the City of Duluth, Minnesota and in that capacity have represented for over twenty (20) years small and very small businesses. My principal activity is assisting these small businesses in getting established financially and assisting them with their financing needs as they grow. I live in a community which has been very hard hit by the loss of a United States Air Force Base and several major employers who have through sale or choice moved to other areas of the United States to do business. I am very excited at the prospect of enterprise zone designation for our community. My understanding is that philosophically the bill is designed to encourage new economic activity in distressed neighborhoods through federal income tax incentives to employers and employees, relaxation of federal, state and local regulatory burdens and special local assistance in a variety of traditional and non-traditional ways.

The incentives included in and contemplated by the bill are important and are beneficial to small businesses. I believe, however, that the incentives could be significantly enhanced by directly addressing the major problem facing most entrepreneurs trying to start up or expand their businesses, namely the need for equity capital. Very few small businesses have sufficient track records to obtain start-up or expansion capital from lenders and very few have sufficient "glamour" to attract the risk takers or venture capitalists to provide them with seed money. It seems to me that the effectiveness of the enterprise zone legislation could be dramatically enhanced by including a feature which offers an unusual incentive to encourage small investors to take risks and back entrepreneurs wishing to do business within the enterprise zone. Specifically, I would urge that a provision be added to the bill which would provide a current federal income tax deduction to an investor willing to make an equity investment in a small enterprise zone company. I firmly believe that such a provision would have the effect of encouraging the doctors, lawyers, accountants, merchants and other residents of an enterprise zone community, who would like to make an investment in their community but are afraid of the risks of investments in small businesses, to invest in enterprise zone companies and help in the creation of jobs in the community in which they live.

I and others are presently in the preliminary stages of seeking to form a capital pool in Duluth, Minnesota designed to invest in or buy companies which can provide new jobs for our community. If the investors in the pool knew that they could get a current tax deduction for all or a part of their investment to the extent their monies were invested directly in enterprise zone companies our job would be significantly less difficult.

The idea of allowing current income tax deductions for very high risk investments consistent with national policy is certainly not new. Mineral exploration activity has been thus encouraged for many years. In the event the business is successful and the investment is later disposed of, taxes would be paid in the usual fashion. Section 1244 of the Internal Revenue Code can be rather easily amended to effect this proposal. The key I believe is to provide a current tax incentive for making the investment to begin with.

Such a direct approach to stimulating investments in small businesses is a most cost efficient and immediate approach to economic revitalization and is fully consistent with the philosophy of this legislation.

Senator BOSCHWITZ. We've had other testimony about this approach, specifically, also regarding section 1244 of the Code, and I'm in agreement with this approach. If you form a capital pool in Duluth and decide that in the event the enterprise zone has these kind of provisions in the final law, that you will commit a certain number of dollars to the enterprise zone, I think that would be a very meaningful thing to include in the application made by the city of Duluth, that such a capital pool has been formed, and this is one of the things the pool is directed to.

Mr. SMITH. The thought has occurred to me that we might need to do two because of the uncertainty of—of designation. And we could do that.

Senator BOSCHWITZ. Yes, let's see how the bill progresses, and I fully expect that there will be such amendments.

Have you heard, Bob, of any of those kind of amendments?

[Whereupon a discussion was held off the record.]

Senator BOSCHWITZ. A lot of people are considering that. We among them, And we probably will do so. Again, there were many changes in the metamorphosis of this bill. You note that there have been changes at each stage, and they have been made to accommodate the administration which considered this at great length. I think in the end they had so much of themselves invested into this that they had to come up with their own bill, and we'll amend it. You know, the executive sometimes proposes and we dispose, as they say, and we will do that in this case because we believe in this legislation just as you do, and we feel we have to make it as effective as possible.

I want to specifically thank you as a private citizen for taking your time, not only to come here, but to come to Washington to pursue the interests of the city in which you live. And, really, that's part of the greatness of our State and the Nation as a whole.

Mr. SMITH. Thank you, Senator.

Senator BOSCHWITZ. MR. LAVOY.

STATEMENT OF JACK LaVOY, BUSINESS DEVELOPER, CITY OF DULUTH, DULUTH, MINN.

Mr. LAVOY. Senator Boschwitz, my name is Jack LaVoy and I'm a business developer with the office of business development for the city of Duluth. Mayor John Fedo had wanted to attend this meeting but couldn't because of previous commitments, so he asked that I express to you his appreciation for this opportunity for the city of Duluth to provide input into the enterprise zone legislative process.

Senator BOSCHWITZ. Mayor Fedo was recently down in Washington, as you know, and was very, very effective, in my judgment, in expressing the case of the city of Duluth to a large number of military contractors. We lose that base up there, at least we can get some military contracts out of it. And I think we're making some progress in that regard. But he was very effective, and tell him I quite understand that he couldn't be here and that we're pleased that you are.

Mr. LAVOY. Well, thank you. I understand that you did us a tremendous benefit by arranging those meetings, and we certainly appreciate it. I'll tell him.

Senator BOSCHWITZ. We got to drive it to conclusion now.

Mr. LAVOY. Right. I've got some information I want to discuss with you after this hearing about the Air Base to update you on where we are with that whole concept.

Senator BOSCHWITZ. Sure. Let's do it.

Mr. LAVOY. OK, the city of Duluth is most pleased to lend its support to the enterprise zone concept. It is our belief that this legislation provides cities such as ours with a unique opportunity to regain the mastery of our economic destiny. Older, northern cities, such as ours, have found our economic vitality to become seriously threatened during the past few decades.

All of the difficulties associated with plant closings, increased unemployment, deteriorating housing and a general downturn in our quality of life and the delivery of governmental services, have been ours to share. Clearly, such a situation is not only contrary to our best interests, but it has general, destructive impact on our country as a whole. For the body of our Nation is only as healthy as the well-being of its many parts. It is our hope that the successful application of the enterprise zone concept will not only alleviate our cities from their distress, but service as a successful catalyst for revitalizing the economy of our Nation.

It is clear from the legislation that you and your colleagues are well versed in the general problems associated with an area's economic decline. Today, however, I would like to briefly review some specific examples involving Duluth and then quickly overview the eligibility criteria outlined in the proposed legislation and discuss its applicability to Duluth.

By anyone's standards, the past decade has been a difficult one for Duluth. In 1972, United States Steel announced its closure of its Duluth works resulting in the loss of 2,600 well-paid, primary income jobs. It was a blow from which we have not yet fully recovered. The following year, Chun King Corp., which employed 604 people at its peak, closed down its Duluth operations. And, in 1979, United States Steel closed its coke plant in Duluth, affecting another 250 jobs.

In light of those losses, it is truly amazing that our population dropped by only 8,000 people during that decade. A good part of the reason, we are sure, lies in Duluth's success in attracting some new industries such as American Hoist and Derrick and Minneapolis Electric Steel Castings and diversifying our tourist economy through the development of Spirit Mountain, the Normandy Inn complex in downtown Duluth, the Depot Heritage and Art Center, and the Arena Auditorium annex. Nonetheless, the new gains by no means totally replaced the decade's loss.

As if some mad social scientist was attempting to see how much adversity a city could take before it finally breaks, the last 2 years have been equally as difficult and in some way more awesome.

The Bombardier Corp., which has its national headquarters in Duluth, ceased operations in 1981, with the loss of 50 jobs.

Hallet Forge, which made grinding balls for the taconite industry, shut its doors in 1981, eliminating another 25 jobs.

Then, the U.S. Air Force, despite tremendous efforts on your part and that of your colleagues, announced it was deactivating its Duluth base, resulting in the loss of another 1,600 jobs.

And, finally, Jeno's announcement that, for competitive reasons, he was relocating his pizza operations to Wellston, Ohio, with a potential additional loss of 1,300 jobs in our community, was an absolutely devastating psychological and economic blow.

And then yesterday—it doesn't say this in the text—we had an explosion at the Alberta Gas & Chemicals factory in Duluth, which destroyed most of the facility and it appears likely it could be the loss of another 65 jobs, and these are good-paying jobs. And to add to the tragedy, the plant was currently in the process of undergoing financial arrangements for an expansion which would have increased their work force by 20.

So clearly, we are in need of help. The job losses which I just outlined for the past decade total 6,505 jobs. To put that in perspective, if jobs losses of similar in proportion were to occur in the Twin Cities, it would mean the loss of 32,525 jobs in Minneapolis and 19,515 jobs in St. Paul, merely over a decade. Had that size of a job loss occurred in either city, it is unimaginable that either the Federal or State government could ignore their cries for help. What we in Duluth are asking, however, are for the tools by which we can help ourselves. We ask that you give your support toward having Duluth designated as one of the first 25 enterprise zones to be established under the proposed legislation.

Senator BOSCHWITZ. I will do that. And I also like to help not only you, but any other community, and put together the application.

Mr. LAVOY. We would appreciate that.

Senator BOSCHWITZ. That would be an important point.

Mr. LAVOY. Senator Ulland addressed some of the problems we have with the new criteria being advocated by the Reagan administration bill. And rather than spend a great deal of time repeating those issues in detail, I want to merely emphasize two points.

First, we ask that the population loss criteria be lowered from the 20-percent figure being advocated by the administration to the 10-percent figure which was in the original Boschwitz bill.

I have two maps here, Senator, if you will, that show the difference in the impact by that kind of an adjustment. This is the city of Duluth and this is the area—in yellow is the areas which would qualify under the administration proposal if it is interpreted properly under the rules and regulations. The clear yellow areas are areas where we've lost 20 percent or greater in population. The hachard [phonetic] area, if combined totally, creates an aggregate population loss in excess of 20 percent. If we don't get the ruling that it would be the aggregate loss of the total district rather than the specific census tracts, as Senator Ulland pointed out, one of the most key census tracts in our community involves two of the Jeno's plants which are proposed for closure, and because a senior citizen high rise was built in that census tract, we would be precluded from using this legislation.

To show you what the 10-percent rule would—impact it would have, that is—these are the areas in Duluth which have averaged an aggregate population loss of 10 percent or greater. The hachard lines, once again, represent census districts, tracts that didn't lose 10 percent but combined with——

Senator BOSCHWITZ. What do you call those lines?

Mr. LAVOY. Hachard. The lined ones.

Senator BOSCHWITZ. Hachard?

Mr. LAVOY. Hachard. Hashmarks.

Senator BOSCHWITZ. Oh. Hashmarks.

Mr. LAVOY. Hash. In Cloquet we said, "haches." [Laughter.]

Senator BOSCHWITZ. They talk funny. They vote funny, too. [Laughter.]

Mr. LAVOY. So the advantage of this—this zone—if the State interprets this regulation improperly this entire area could be combined into an enterprise zone, it would be the area we would most desire to have eligible for Federal designation as well for a number of reasons. It would allow us to take care of the problems we have with the Jeno's plants along the waterfront areas; it would also provide us with an opportunity for redeveloping the 500-acre unit—our industrial park here in the western part of our community. And this would pretty well encompass the industrial areas of our town with the exception of air park and the new base facilities which we have available for redevelopment. And that is one of the reasons we feel that the 10-percent population loss criteria is so much more acceptable and beneficial to our community than the administration's——

Senator BOSCHWITZ. We will try. You and Senator Ulland have sensitized us to that problem. It's an important change when you put it in this way.

I compliment you for the long way in which you have already gone in trying to adapt yourself to this particular new bill. I might ask one of our staff people to put it up here so that I, now having seen it, perhaps, some of the people in the audience might see it as well. The enterprise zone concept has grown to some degree out of the free port concept, where things could be brought into a free port area and then reprocessed and shipped out without any taxation on the increment and value. And so when I see it there in the port area, it has a particular applicability to the germination of this concept that we have. And how it started in Great Britan, where it has been put into effect initially.

Pardon me for interrupting you, Jack.

Mr. LAVOY. And, secondly, we ask that language be included in the legislation which gives preference to communities which are seriously impacted by the closure of a major Federal installation. This is in our State legislation and we believe it is only fair to have it included in the federal bill. For, if the Federal Government takes actions for economies which negatively impact a community to the degree it has ours, it seems only fair that we be given the tools to build the foundation for our own recovery.

Rather than spend a great deal of additional time discussing aspects of the legislation, which I believe have been or will be covered by others, I will conclude by reemphasizing the city of Duluth's support for the enterprise zone legislative concept and our desire to be one of the initial zones designated by the Federal Government once this legislation passes.

We believe that given the proper tools which are provided for in this legislation, the foundation can be laid for the economic recovery of Duluth and its reemergence as a major manufacturing center.

Thank you for this opportunity to speak on this important issue. If you have any questions, I'd be more than happy to try to answer them.

[The prepared statement of Mr. LaVoy follows:]

STATEMENT OF JACK LAVOY, BUSINESS DEVELOPER, CITY OF DULUTH, DULUTH, MINN.

Senator Boschwitz and members of the Committee, my name is Jack LaVoy and I'm a Business Developer for the City of Duluth. Unfortunately, other commitments make it impossible for Duluth Mayor John Fedo to attend this meeting, so he asked that I appear in his stead and convey to you his appreciation for this opportunity for the City of Duluth to provide input into the Enterprise Zone legislative process.

The City of Duluth is most pleased to lend its support to the Enterprise Zone concept. It is our belief that this legislation provides cities such as ours with a unique opportunity to regain the mastery of our economic destiny. Older, northern cities, such as ours, have found our economic vitality to become seriously threatened during the past decade.

All of the difficulties associated with plant closings, increased unemployment, deteriorating housing and a general downturn in our quality of life and the delivery of governmental services, have been ours to share. Clearly such a situation is not only contrary to our best interests, but it has a general, destructive impact on our country as a whole. For the body of our Nation is only as healthy as the well-being of its many parts. It is our hope that the seccessful application of the Enterprise Zone concept, will not only alleviate our cities from their distress, but serve as a successful catalyst for revitalizing the economy of our Nation.

It is clear from the legislation, that you and your colleagues are well-versed in the general problems associated with an area's economic decline.

Today, however, I would like to briefly review some specific examples involving Duluth and then quickly overview the eligibility criteria outlined in the proposed legislation and discuss its applicability to Duluth.

By anyone's standards, the past decade has been a difficult one for Duluth.

In 1972, U.S. Steel announced its closure of its Duluth Works resulting in the loss of 2,600 well-paid, primary income jobs. It was a blow from which we have not yet fully recovered.

The following year, Chun King, which employed 604 people at its peak, closed down its Duluth operations.

And, in 1979, U.S. Steel closed its coke plant in Duluth, affecting another 250 jobs.

In light of those losses, it is truly amazing that our population dropped by only 8,000 people during that decade. A good part of the reason, we are sure, lies in Duluth's success in attracting some new industries such as American Hoist and Derrick and Minneapolis Electric Steel Castings and diversifying our tourist economy through the development of Spirit Mountain, the Normandy Inn complex in downtown Duluth, the Depot and the Arena-Auditorium annex. Nonetheless, the new gains by no means totally replaced the decade's loss.

As if some mad social scientist was attempting to see how much adversity a city could take before it finally breaks, the last two years have been equally as difficult and in some ways more awesome.

The Bombardier Corp., which had its national headquarters in Duluth, ceased operations in 1981, with the loss of 50 jobs.

Hallet Forge, which made grinding balls for the taconite industry, shut its doors in 1981, eliminating another 25 jobs.

Then, the United States Air Force, despite tremendous efforts on your part and that of your colleagues, announced it was deactivating its Duluth Base resulting in the loss of another 1,600 jobs.

And finally, Jeno's announcement that, for competitive reasons, he was relocating his pizza operations to Wellston, Ohio, with a potential additional loss of 1,300 jobs, was an absolutely devastating psychological and economic blow.

Clearly, we are in need of help. The job losses which I just outlined for the past decade total 6,505 jobs. To put that in perspective, if jobs losses similar in proportion were to occur in the Twin Cities, it would mean the loss of 32,525 jobs in Minneapolis and 19,515 jobs in St. Paul. Had that size of a job loss occurred in either city it is unimaginable that either the Federal or State Government could ignore their cries for help. What we in Duluth are asking, however, are for the tools by which we can help ourselves. We ask that you give your support towards having Duluth designated one of the first twenty-five Enterprise Zones to be established under the proposed legislation.

I know that others from Duluth are prepared to address some of the problems we have with the new criteria being advocated by the Reagan Administration bill. Rather than spend a great deal of time repeating those issues in detail, I want to merely emphasize two points.

First, we ask that the population loss criteria be lowered from the 20 percent figure being advocated by the Administration to the 10 percent figure which was in the original Boschwitz bill.

And, secondly, we ask that language be included in the legislation which gives preference to communities which are seriously impacted by the closure of a major Federal installation. That is in our State legislation and we believe it only is fair to have it included in the Federal bill. For, if the Federal Government takes actions which negatively impact a community to the degree it has ours, it only seems fair that we be given the tools to build the foundation for our own recovery.

Rather than spend a great deal of additional time discussing aspects of the legislation, which I believe have been or will be covered by others, I will conclude by reemphasizing the City of Duluth's support for the Enterprise Zone legislative concept and our desire to be one of the initial Zones designated by the Federal Government once this legislation passes.

We believe that given the proper tools which are provided for in this legislation, the foundation can be laid for the economic recovery of Duluth and its re-emergence as a major manufacturing center. Thank you for this opportunity to speak on this important issue. If you have any questions, I'd be more than happy to try and answer them.

Senator **Boschwitz**. Well, I appreciate your reemphasizing Jim Ulland's testimony, again. I had not considered the second point you make, either, and that is to consider the closure of a major Federal installation as part of one of the categories. I'll think about it, and pardon me if I don't make a commitment on it. But I think it is a good idea and it's a constructive approach that we should consider where Federal Government has imposed some problem onto the area, that it should be part of the solution.

I have found working with the people from the city of Duluth to be a constructive experience. I find yours and Jim Ulland's testimony this morning to be very much in continuation of that same constructive vein. And we thank you for coming and testifying. I want to add that Jim's points are well taken, and we may very well introduce changes in the legislation.

Mr. LAVOY. Thank you. One thing that Senator Ulland touched upon was the 5 square mile criteria, and where he got that was from a handout provided by HUD dated March 1982. And it just says on page 28:

> Addition factors determine which zones—determining which zones will be federally approved will relegate—relate to the size and location of the zones. Zones will be on an average, be expected to be one to two square miles, but larger zones of as much as 5 square miles would be acceptable in larger communities, though not too many zones of this size would be approved.

Senator BOSCHWITZ. Read that again.

Mr. LAVOY. It says:

> Zones on an average be expected to be 1 to 2 square miles, but larger zones of as much as 5 square miles would be acceptable in the larger communities, though not too many zones this size would be approved. In smaller community zones of even one-half square mile might be suitable.

So it could be—it could be a consideration of importance if at some future date Superior, Wis., were to approach the city of Duluth about a cooperative effort or something, by limiting us to merely 5 square miles. Hopefully, there could be some flexibility left to the community in deciding exactly how much space it felt was feasible to be adopted for zone usage, rather than have an aribitrary number picked.

[Whereupon a discussion was held off the record.]

Ms. SAUNDERS. I was just saying there's nothing in the bill that designates what the size of the zone has to be. HUD had to make some sort of an estimate of what they expect the size to be in order to come up with revenue estimates on the bill. So that is something that—the 5 square miles—they're thinking right now could be within those constraints. We're discussing it with them because we recognize that in some rural areas, as well as in your case up in Duluth, we might want the size to be unlimited.

Mr. LAVOY. OK. I just wanted you to be aware that there is some movement——

Senator BOSCHWITZ. Do you have any comments, Bob?

Mr. WILSON. No.

Senator BOSCHWITZ. What is the approximate size and the area of the yellow outlined space there?

Mr. LAVOY. On the larger 10 percent one I'm not quite sure. I haven't calibrated it. The city is 2 miles long and 20—or 2½ miles wide and 20 miles long, and what you see there is about half the geographical length of the city, and so it's—I really don't know. I could be about 10 square miles possibly if you were to include the steel plant site and so forth.

Senator BOSCHWITZ. That was 500 acres, which is almost a square mile by itself.

Mr. LAVOY. Yes.

Senator **Boschwitz**. Do you have some other comments that you wanted to make?

Mr. **Smith**. If I could just add a little bit to that point, Senator. At the workshop that I attended discussing the enterprise zone legislation there was quite a bit of concern expressed on behalf of people from smaller communities about—about the difficulty within smaller communities of being—of being very site specific, and about the requirements that they—that the zone designation be a continuous—that the—that the area be continuous. And I think that kind of goes along with what Mr. LaVoy was just saying and I just wanted to add that.

Mr. **LaVoy**. One other consideration, if I could just briefly touch again on the cooperative business. The city—or the port authority in Duluth does have foreign trade zone designation, and under that legislation we are able to—to apply for and manage subzones in Superior if we ever received requests to do so, and possibly that kind of process could apply to this, whereby in the future if there's some determination a cooperation would be desirable, or they have a need over there that could be addressed, that we could go through some type of amendment process similar to the way foreign trade zones are handled.

[Whereupon a discussion was held off the record.]

Mr. **Wilson**. No; that is a part of legislation that—that enterprise zones would also be eligible for free trade zone designation.

Mr. **LaVoy**. Oh, I know. I was just talking about the process for expanding an enterprise zone or enlarging it boundaries at some future date, it possibly could be patterned after the way we're able to amend our foreign trade zone applications.

Thank you.

Senator **Boschwitz**. I could see some political pluses, too, getting two States, four Senators. And in the final analysis, unless I miss my guess, we will all be involved in pushing our various applicants, so that it is worthwhile to get.

Mr. **LaVoy**. As long as the geographic restrictions wouldn't apply, there really wouldn't be any problem as far as that is concerned.

Senator **Boschwitz**. Well, we thank you gentlemen for coming.

Mr. **LaVoy**. Thank you.

Senator **Boschwitz**. We were helped by your testimony, and it's very nice to see you again.

Mr. **Smith**. Thank you.

Senator **Boschwitz**. As our final witness we have Walter Tiffin of the First Midwest Corp. You're associated with Buddy Ruvelson; is that correct?

Mr. **Tiffin**. That's correct. He is president of our company and couldn't make it today because of a problem with one of our portfolio companies.

Senator **Boschwitz**. Listen, he's only got a problem with one?

Mr. **Tiffin**. One this morning.

Senator **Boschwitz**. Oh. I see. But I've known Mr. Ruvelson for many years, one of the most creative guys around, and with a special interest in small business, not only as an advocation, but as a preoccupation and as a livelihood, and a highly respected person in our community.

I don't believe we've met before. Have we?

Mr. TIFFIN. No; we have not, Senator.

Senator BOSCHWITZ. But it's a pleasure to welcome you this morning, and we welcome your testimony as well.

STATEMENT OF WALTER L. TIFFIN, VICE PRESIDENT AND TREASURER, FIRST MIDWEST CORP., MINNEAPOLIS, MINN.

Mr. TIFFIN. Thank you. First, about our corporation, First Midwest Corp., we're a holding company and our major operation is that of being—of providing long-term venture capital to emerging and growing business concerns. We do this through our subsidiary, First Midwest Capital Corp., which is the Nation's first small business investment company. We've been in this business since 1959. Being in this business we are in close contact daily with small business, with entrepeneurs that want to start a small business or expand a small business. And we very strongly support the efforts that are outlined in this legislation to encourage the formation and success of small businesses.

We feel that the provisions of this act once implemented should assist the private sector in the development of businesses within the enterprise zone, and we feel should create additional employment both within, and I think, without—outside of the zones, and definitely be a stimulation for revitalization within the areas.

Looking at the legislation from a small business point of view, one thing you mentioned in your introductory remarks is that the majority of small businesses tend to lose money in their early years. In reading most of the tax incentive provisions in this legislation, these provisions tend to benefit small business concerns once they become profitable. Specifically, the carry forward provisions, the credit provisions do reduce income taxes and do improve cash flow at that time, but they improve it when a company becomes profitable. Big needs of a lot of small businesses are earning cash flow in their early stages when they're having extreme difficulty in making money. This is an area I'd like the committee to give consideration to. I don't know that I've got any particular answers, but from the small businessman's point of view, it would be helpful.

Senator BOSCHWITZ. You know, if I may interrupt you, Mr. Tiffin, I really took that case, having had the experience—and I'll knock on wood [indicating]—I made money the first year I was in business but—but I think I only knew that at the end of the year. I think I lost money for quite some time and then made it back as the year progressed and I got a little better at what I was doing. But I recognize that our bill addresses profits. That's below the line, you know. A net profit before taxes. And that many small businesses don't get to that, and I tried to be as insistent as I could to impact things above the line; the expenses. The States and municipalities are, perhaps, in a little better position to do so.

As I mentioned earlier, the taxes that we collect and that we can waive are basically the unemployment tax, social security tax, which is a tax on wages. We tried to waive a portion of that and, boy, did we run into a hailstorm. There are not many parts of the expense aspects of a business other than income taxes, which I don't think you could get waived. The Treasury would just go berserk. And so we kind of cast that part of it on to the cities and on to the States. They have more of those expense items; occupancy, interests, real estate taxes, workmen's compensation taxes, which are normally larger elements and have been more historically waived. And when you put together as a package, with what we have done, would make it very much more inviting.

But if you will continue with your testimony.

Mr. **Tiffin**. There is one provision in the legislation for the possible elimination of capital gain taxes on qualified property, and this I strongly endorse. But, I think, as we all know, a number of small businesses do not make it. And as a benefit to potential investors looking at investing in these firms, I would recommend that the capital losses or the losses that they sustain on investments in these firms or advances to these firms could possibly be afforded ordinary loss treatment and, therefore, be deducted from the investor's ordinary income rather than be treated as capital losses.

It's been our experience working with a large number of entrepreneurs that most——

Senator **Boschwitz**. You want—pardon me for interrupting you——

Mr. **Tiffin**. Sure.

Senator **Boschwitz** [continuing]. But let me just clarify this. You would recommend capital losses on investments in or loans to firms be afforded ordinary—that's 1244 once again.

Mr. **Tiffin**. Right.

Senator **Boschwitz**. And you would propose that in the event that there were losses or just loans. In other words, it did not——

Mr. **Tiffin**. Either. Right.

Senator **Boschwitz**. Somewhere along the line of Mr. Smith's.

Mr. **Tiffin**. Somewhere along the line that was previously discussed.

Another area, most of the entrepreneurs we work with seem to be very strong in one particular area of their business; sales, marketing, engineering, whatever, and their learning curve to become experts in all areas of business in a large number of cases takes a lot of years. And I would like to see that one of the criteria that could be considered in establishing these enterprise zones would be the availability of a broad base of managerial assistance within the community. I know in the Twin Cities one of the good organizations to give that managerial assistance is the Service Corps of Retired Executives [SCORE], and we've worked with them on a number of cases and think they do a very good job in assisting small business concerns.

Senator **Boschwitz**. That comes within the scope of the FDA, so that it comes under the aegis of this committee, so it's something that can be affected.

I might say that Bill Norris, chairman of Control Data, was in and spoke. His plea was that we should appropriate some moneys to build the intrastructure organizations in the neighborhood, so the enterprise zones could overcome some of the difficulties that Mr. Atwood had.

Mr. **Tiffin**. I think that would be a very good step.

Senator **Boschwitz**. Did you read your concluding——

Mr. **Tiffin**. No; I did not. Thank you for the opportunity to testify at these hearings, and I do wish you and the committee success.

[The prepared statement of Mr. Tiffin follows:]

STATEMENT BY WALTER L. TIFFIN, VICE PRESIDENT AND TREASURER, FIRST MIDWEST CORPORATION, SUITE 700 CHAMBER OF COMMERCE BUILDING, MINNEAPOLIS, MINNESOTA BEFORE SUBCOMMITTEE ON INFLUENCING SMALL BUSINESS INVESTMENT IN ENTERPRISE ZONE, SENATE SMALL BUSINESS COMMITTEE ON MAY 7, 1982

First Midwest Corporation is a holding company with our major operation being that of providing long term capital to emerging and growing business concerns through our subsidiary First Midwest Capital Corporation, the nation's first Small Business Investment Company. Being in this business we are in very close contact with small business and entrepreneurs in a broad variety of industries and work with them daily. We strongly support efforts such as those outlined in this legislation to encourage the formation and success of small business.

The provisions of this Act once implemented should assist the private sector in the development of small business within the "Enterprise Zones". This legislation should create additional employment both within and without the designated zones and be a stimulation for revitalization within the areas.

It has been our experience over the years that the majority of small businesses loose money in their early start-up years. In reading the Tax Incentive provisions in this legislation it appears that the principal benefits to the small business concerns are realized when the companies become profitable. Specifically the carryforward provisions and the credit provision do reduce taxes and improve cash flow when a company becomes profitable but that is not beneficial to the small business concern which is loosing money. I do not have any specific recommendations to advance at this time but would recommend the Committee give consideration to benefits which could be realized during these early loss years.

The provision in the legislation for the elimination of capital gains taxes on qualified property is a provision I strongly endorse. As a further benefit to potential investors in these firms I would recommend that capital losses on investments in or loans to firms in the "Enterprise Zone" be afforded ordinary loss treatment and, therefore, be deducted from ordinary income rather than being treated as capital losses which can only be offset against capital gains.

Most entrepreneurs are strong in one area of business such as sales or engineering but do not normally have the broad business experience in all areas of business which is needed to successfully run a growing business. I believe additional criteria which should be considered in establishing the "Enterprise Zones" should be the availability of a broad base of managerial assistance within the community from organizations such as Service Corps of Retired Executives (SCORE).

Thank you for the opportunity to testify at these hearings and I do wish you and the committee success with this program.

Senator **Boschwitz**. Well, I thank you for coming, Mr. Tiffin. You have emphasized the intrastructure, which only two witnesses have brought to our attention.

And I want to thank all the witnesses for coming, because it has been a good experience. They certainly have done their homework. They have read the HUD material. They are very familiar with the zone, seem to be very determined in getting the zone. And I'm particularly impressed with the early work that's already been done. And I look forward to helping all communities in our State seek application for an enterprise zone.

The 10 percent is something which was not considered before and I didn't recognize that it had been changed in this bill, and, also, I will give them consideration and look into the size of the zone since, apparently, HUD, for whatever reason, is going in the direction of restricting zones to such a small area, that, perhaps—Sally Howard's comment, that they were only directed at the large and very popular cities. Perhaps, she was right in that case. If the enterprise zones are going to be very narrow in size.

So you helped us this morning. I'm pleased we've had the hearing and we thank, again, all the witnesses who have come. And this hearing will stand adjourned.

[Whereupon, the hearing concluded at 12:15 p.m.]

APPENDIX

Vorys, Sater, Seymour and Pease

ARTHUR I. VORYS
1856-1933
LOWRY F. SATER
1867-1936
AUGUSTUS T. SEYMOUR
1873-1926
EDWARD L. PEASE
1873-1924
ARTHUR I. VORYS
JOHN C. ELAM
RUSSELL P. HERROLD, JR.
CHARLES D. MINOR
EDGAR A. STRAUSE
WILLIAM W. ELLIS, JR.
RICHARD G. ISON
JAMES P. KENNEDY
HERBERT R. BROWN
EDWARD A. SCHRAG, JR.
COLBORN M. ADDISON
LESTER S. LASH
ROGER A. YURCHUCK
JERRY O. JORDAN
JACOB E. DAVIS II
CHARLES F. DUGAN II
DUKE W. THOMAS
RICHARD R. STEDMAN
SHELDON A. TAFT

THOMAS M. TAGGART
JAMES B. CUSHMAN
ROBERT W. WERTH
KENNETH D. BECK
GEORGE L. JENKINS
JAMES H. GROSS
PHILIP W. STICHTER
JAMES R. BEATLEY, JR.
SCOTT N. WHITLOCK
LAWRENCE L. FISHER
THOMAS B. RIDGLEY
ROBERT W. MINOR
JOHN W. HOBERG
JAMES P. FRIEDT
PHILIP C. JOHNSTON
WILLIAM D. KLOSS
MICHAEL G. LONG
THOMAS M. TARPY
KENNETH M. ROYALTY
ROBERT F. WEAVER, JR.
DAVID S. CUPPS
JAMES H. HEDDEN
DANIEL H. SCHOEDINGER
PHILLIP L. NUNNALLY
SUSAN BROWN MOORE
JOSEPH D. LONARDO
MICHAEL W. DONALDSON
MICHAEL J. CANTER
LEON M. McCORKLE, JR.

RUSSELL M. GERTMENIAN
ALAN T. RADNOR
MARY ELLEN FAIRFIELD
C. WILLIAM O'NEILL
ROBERT E. TAIT
CHARLES S. DeROUSIE
GEORGE N. COREY
FREDERICK R. REED
G. ROSS BRIDGMAN
W. JONATHAN AIREY
STEVEN J. McCOY
PHILIP A. BROWN
STEPHEN R. BUCHENROTH
JAMES M. BALL
JOHN K. KELLER
LANCE W. SCHNEIER
R. GUY COLE, JR.
ROBERT A. MINOR
RONALD L. ROWLAND
SUZANNE K. RICHARDS
DONALD J. SHULLER
GARY E. DAVIS
F. DANIEL BALMERT
JONATHAN M. NORMAN
SUSAN J. INSLEY
JOHN TIMOTHY YOUNG
ROBERT D. MORAN*
THOMAS R. BOLAND*
SANDRA J. ANDERSON

DANNY L. VOGUS
JAMES A. YANO
VIRGINIA M. TRETHEWEY
NANCY L. DANISON
IVERY D. FOREMAN
BRUCE L. INGRAM
LAURA G. KUYKENDALL
JAMES L. TODD
BRUCE R. HENKE
OWEN R. KATZMAN*
JOSEPH V. LANE, JR.
RAYMOND D. ANDERSON
GERALD P. FERGUSON
GEORGE N. VORYS
ROGER E. LAUTZENHISER
J. SCOTT JAMIESON
JACINTHA KRAFT BALCH
JAMES E. PHILLIPS
JOHN P. WELLNER
AARON P. ROSENFELD
JOHN W. WILMER, JR.*
CHRIS J. NORTH
WILLIAM L. McCLAIN
JOHN C. VORYS
REGINALD W. JACKSON
CARL D. SMALLWOOD
GAYLE ROBINSON WESTBROOK
JOSEPH A. BRUNETTO
ROBERT J. MULLIGAN

JOHN J. KULEWICZ
TERRY M. MILLER
DAVID W. HARDYMON
STEVEN W. MERSHON
ANNE C. GRIFFIN
J. ANDREW CRAWFORD
MARK A. HUDDY
WILLIAM A. KLATT
STEPHEN L. DICKINSON
DIANE MARSHALL ENNIST
ROBERT G. DYKES
CHARLES W. HESS
JONATHAN D. ITEN
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CHARLES A. WEBB*
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LYNDA S. ZENGERLE*
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February 24, 1982

Senator Lowell P. Weicker
Chairman
Senate Committee on Small Business
424 Russell Senate Office Building
Washington, D. C. 20510

Attn: Mr. Robert M. Wilson
Counsel

Dear Mr. Chairman:

We respectfully request that the enclosed written statement of Mr. John W. Blatt, president of the Toledo (Ohio) Area Small Business Association and president of the Kerscher Elevator Company, an employer within an urban enterprise zone be included in the permanent hearing record and printed hearings on the Committee's consideration of the role of small business in Federal urban enterprise zone legislation and designation.

Respectfully requested,

Randal C. Teague

RCT:ms
Enc.

WRITTEN TESTIMONY OF:

JOHN W. BLATT
PRESIDENT, KERSCHER ELEVATOR COMPANY
TOLEDO, OHIO

PRESIDENT
TOLEDO AREA SMALL BUSINESS ASSOCIATION

PRESENTED TO:

CONGRESS OF THE UNITED STATES
SENATE COMMITTEE ON SMALL BUSINESS
ENTERPRISE ZONES

February 15, 1982

Written statement of John W. Blatt, President, Kerscher Elevator Company and President, Toledo Area Small Business Association for the U. S. Senate Committee on Small Business.

Mr. Chairman and members of the Committee:

I AM JOHN W. BLATT, PRESIDENT OF KERSCHER ELEVATOR COMPANY HERE IN TOLEDO, OHIO, AND PRESIDENT OF THE TOLEDO AREA SMALL BUSINESS ASSOCIATION.

I SPEAK AS A SMALL BUSINESS PERSON, I OWN A SMALL BUSINESS. I SPEAK FOR OTHER SMALL BUSINESS OWNERS AS PRESIDENT OF THE TOLEDO AREA SMALL BUSINESS ASSOCIATION.

OUR ORGANIZATION (TASBA) HAS 500 MEMBERS IN NORTHWEST OHIO AND SOUTHEAST MICHIGAN, REPRESENTING 10,000 EMPLOYEES AND 35,000 FAMILY MEMBERS. WE ARE THE OLDEST AND LARGEST ACTIVE REGIONAL SMALL BUSINESS GROUP WHICH OPERATES INDEPENDENTLY FROM THE CHAMBER OF COMMERCE -- WE REPRESENT ONLY SMALL BUSINESS. IN TURN WE ARE REPRESENTED IN WASHINGTON BY SMALL BUSINESS UNITED AND IN COLUMBUS BY THE OHIO COALITION OF SMALL BUSINESSES. WE JOIN 3 MILLION ACTIVE SMALL BUSINESS OWNERS IN WORKING FOR THE CONTINUATION OF THE FREE ENTERPRISE SYSTEM.

NEARLY ALL HISTORIC GROWTH IN JOBS HAS BEEN BY SMALL BUSINESS. TASBA MEMBERS HAVE CREATED MORE NEW TOLEDO AREA JOBS THAN ALL THE FORTUNE 500 FIRMS IN OUR CITY IN THE LAST 5 YEARS. WE HAVE CREATED NEARLY 3,500 JOBS. WE WILL CONTINUE TO CREATE JOBS THROUGH BUSINESS START-UP AND EXPANSION -- IF GIVEN THE OPPORTUNITY TO DO SO.

TASBA MEMBERS ARE IMPRESSED WITH AND PROUD OF THE TOLEDO ECONOMIC DEVELOPMENT PLAN AND ARE ACTIVE PARTICIPANTS IN ITS DEVELOPMENT AND IMPLEMENTATION. OUR SPECIFIC 1982 PROGRAM CALLS FOR INCREASED INVOLVEMENT IN WARREN-SHERMAN, EXPORT ASSISTANCE, AND SMALL BUSINESS FINANCING. WE VIEW THE ENTERPRISE ZONE ACT AS AN ABSOLUTELY NECESSARY PORTION OF THE ECONOMIC REVITALIZATION OF OUR COMMUNITY.

SPECIFICALLY, WE KNOW OF MANY COMMUNITIES WHICH HAVE DRESSED-UP THEIR BUSINESS DISTRICTS. BUT WE KNOW OF NO OTHER CITY WHICH HAS UNDERTAKEN SUCH A COMPREHENSIVE ECONOMIC DEVELOPMENT PROGRAM. ONE HAS ONLY TO LOOK AT THE REBUILT CENTRAL BUSINESS DISTRICT, THE VISTULA NEIGHBORHOOD REHABILITATION PROGRAM, THE WARREN-SHERMAN AREA, THE WATERFRONT IMPROVEMENTS, THE PLANS FOR UTILIZATION OF THE MIDDLEGROUNDS AND THE PLANS FOR A SPORTS AND CONVENTION CENTER TO OBSERVE THE COMPLETENESS OF THE TOLEDO PLAN. THE DOWNTOWN RENOVATION PROGRAM IS A STORY OF COOPERATIVE EFFORT -- THE GOVERNMENT HAS CONTRIBUTED AND THE PRIVATE SECTOR HAS RESPONDED. BUT BEYOND THE MAJOR STORIES OF OWENS ILLINOIS AND TOLEDO TRUST ARE THE SMALL BUSINESS SUCCESSES OF FORT INDUSTRY SQUARE, THE OHIO BUILDING, ONE

LAKE ERIE CENTER, TOLEDO GARDENERS, INNS OF COURT, FRANKLIN PRINTING, GILBERT MAIL, AND OTHERS WHO HAVE REINVESTED THEIR OWN DOLLARS IN THE REDEVELOPMENT OF OUR INNER CITY.

WE FEEL THAT THE TOLEDO ECONOMIC DEVELOPMENT PLAN TRULY REPRESENTS A COOPERATIVE EFFORT AND THAT IT IS UNIQUE. BUT THAT IS NOT THE ENTIRE STORY.

TOLEDO'S PLAN DOESN'T STOP AT BRICKS AND MORTAR. IT ENCOMPASSES THE PROGRAM AND VISION TO CONVERT TOLEDO FROM AN AUTO-DEPENDENT COMMUNITY TO A DIVERSIFIED STABLE ECONOMY. ALL ELEMENTS OF THE COMMUNITY ARE INVOLVED -- ALL SEGMENTS OF THE ECONOMY ARE BEING STUDIED FOR AVENUES OF GROWTH -- ALL CITIZENS ARE BEING ENCOURAGED TO PARTICIPATE.

I FIRMLY BELIEVE OUR ECONOMIC DEVELOPMENT PROGRAM WILL WORK. I BELIEVE IT IS WORKING NOW. I BELIEVE IT WILL WORK OVER THE NEXT SEVERAL YEARS.

THE KEY ELEMENT OF OUR RECOVERY IS IN YOUR HANDS. WARREN-SHERMAN NEEDS TO BE IDENTIFIED AS AN ENTERPRISE ZONE AND SMALL BUSINESS NEEDS TO BE GIVEN ECONOMIC INDUCEMENTS TO LOCATE THERE. GIVEN THE FINANCIAL PACKAGE NOW BEING DISCUSSED, I CAN GUARANTEE YOU THAT THE LOCAL SMALL BUSINESS COMMUNITY WILL RESPOND AND WILL MOVE INTO THE AREA AND WILL CREATE NEW JOBS AND WILL PROVIDE NEW SERVICES AND WILL BRING THE AREA BACK ON ITS FEET.

IN ECONOMIC DEVELOPMENT DISCUSSIONS HELD BY AND FOR TASBA MEMBERS, WE HAVE IDENTIFIED A STRONG INTEREST IN THE WARREN-SHERMAN AREA, IF IT IS ENDORSED AS AN ENTERPRISE ZONE. THE PROPOSED CAPITAL GAINS ELIMINATION WILL ENCOURAGE SIGNIFICANT INVESTMENT. THE PROPOSED INCOME AND PROPERTY TAX REDUCTIONS WILL ENABLE GROWING BUSINESSES TO FINANCE MORE OF THAT GROWTH INTERNALLY.

THESE FINANCIAL INDUCEMENTS ARE ESSENTIAL TO THE REBIRTH OF WARREN-SHERMAN BECAUSE OF THE OTHER INFLUENCES AFFECTING SMALL BUSINESS TODAY.

IN PARTICULAR, WE ARE PREVENTED FROM EXPANDING OUR BUSINESSES DUE TO THE HIGH INTEREST RATES SET BY THE FEDERAL RESERVE BOARD. WE ARE FURTHER DISCOURAGED BY THE FEDERAL GOVERNMENT'S RECENT MOVES TO SUPPORT THE SAVINGS AND LOAN INSTITUTIONS BY AUTHORIZING "ALL SAVER'S" CERTIFICATES, WHICH RESULTED IN A SEVERE DRAIN ON AVAILABLE CAPITAL OUT OF OUR AREA AND INTO THE MAJOR MONEY MARKETS. "ALL SAVER'S" CERTIFIFCATES MERELY MOVED MONEY FROM ONE ACCOUNT TO ANOTHER. NO NEW SAVINGS WERE GENERATED -- NO NEW FUNDS MADE AVAILABLE FOR BUSINESS EXPANSION. FEWER FUNDS ARE NOW AVAILABLE TO SMALL BUSINESS.WITH THE ENTERPRISE ZONE ACT BUSINESSES WILL BE FINANCIALLY ENCOURAGED TO LOCATE IN WARREN-SHERMAN AND WILL BE PERMITTED TO RETAIN MORE OF THEIR EARNINGS TO CREATE MORE BUSINESS GROWTH AND MORE JOBS. MORE TAXPAYERS WILL RESULT AND A MORE STABLE ECONOMY WILL DEVELOP.

THE COUNTRY NEEDS ENTERPRISE ZONES -- SMALL BUSINESS NEEDS ENTERPRISE ZONES -- TOLEDO NEEDS WARREN-SHERMAN TO BE AN ENTERPRISE ZONE.

YOU MAKE THE ZONE -- WE'LL MAKE THE JOBS.

THANK YOU.

MHPC
Metropolitan Housing and Planning Council

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Metropolitan Housing and Planning Council
Testimony Submitted to
Senate Select Committee on Small Business
April 15, 1982

Enterprise zones can succeed only if part of a comprehensive urban policy. By definition, enterprise zones are intended to address discrete small scale urban pockets, not wholesale rejuvenation of cities. By admission, enterprise zones are an experiment to test and demonstrate the effect of unfettered free-market innovations. Today, that comprehensive urban policy is not articulated by any level of government.

The proposed Federal Enterprise Zone Act properly shifts the focus of government programs aimed at distressed urban areas to the economic base of the city. This shift need not be at the expense of meeting housing and other urban needs but rather offers necessary ingredients to give people access to housing and services in an economically strengthened neighborhood.

There will be no magic in enterprise zones. They will work only if carefully planned at the local level, if all the essential program ingredients are included and if there are community strengths and leadership on which to build. Enterprise zones involve careful choices in order to provide economic incentives for businesses, both large and small, and economic opportunity for city residents, particularly those now unemployed in the zone, both without undermining the fiscal integrity of federal, state and local governments. Enterprise zones must forge a creative partnership between business, labor, government and the community to create the conditions ripe for the development and enhancement of the urban economic base.

The successful innovations that emerge from the enterprise zone experiment can be adapted and adopted in other places and on a larger scale. Imaginatively designed, enterprise zones can provide a testing ground for innovations in areas like regulatory relief, incubator space, capital formation for new small businesses and cooperative ventures by business, government and community to provide local public services. The competitive nature of the designation process at all levels of government will no doubt and regrettably lead to the inclusion in all applications of costly and not always appropriate program elements, in particular, property tax breaks and massive infrastructure investments. This kind of action, especially by financially strapped local governments, could lead to a political backlash should its consequence be a revenue loss only able to be made up by increased taxes or reduced services in those parts of a community not within an enterprise zone.

The Council has identified in the course of its study of the enterprise zone concept certain priorities to be weighed in determining preferences for zone designation:

- -- First, zones should be of a scale and composition to make them success oriented. They should be small enough to focus services and incentives and to measure results.
- -- Second, zones should be eligible for and be a target of all existing government programs and technical assistance. We must use the resources now in place in a more effective and creative manner before expanding the repertoire.
- -- Third, zones should address the needs of small and minority businesses at the least cost to government. Not tax breaks but capital formation should have priority. Small business development today produces the overwhelming majority of America's new jobs.
- -- Fourth, the expected institution of a federal enterprise zone program and the burgeoning of companion state and local models requires attention to the administration of the program by all levels of government. Proposals to date tend to give their attention to incentives and designation, not to practice and evaluation.

Enterprise zones are not a comprehensive urban policy but could be a valuable part of one. Enterprise zones bet that inner city areas are a sound investment given the right combination of economic incentives and business, labor, government and community participation. The Council supports that bet. We urge concentration on a few carefully developed and meticulously evaluated demonstrations instead of a proliferation of free-fire zones, some of which may succeed by chance. The federal legislation should enumerate the elements listed above as warranting priority in zone designation; yet critically, no one particular incentive, least of all tax breaks, should be even implicitly held out as a threshold requirement. Each prospective enterprise zone must be judged on its potential for success and on the care given to developing a program precisely targetted to the needs and possibilities of the proposed zone.

The Metropolitan and Housing Planning Council is a 48-year old civic group long involved with comprehensive planning issues in the Chicago metropolitan area. Our consideration of the enterprise zone concept has led to the Council's participation on the Governor's Task Force for Illinois Enterprise Zone Legislation.

LOWELL WEICKER, JR., CONN., CHAIRMAN

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 21, 1982

Mr. G. Cheston Carey, Jr.
President
Carey Machinery & Supply Co., Inc.
Post Office Box 206
Baltimore, Maryland 21203

Dear Mr. Carey:

I would like to personally thank you for testifying before the Senate Committee on Small Business on Thursday, February 25, 1982. I believe that through this hearing, we have begun to build a record of what small businesses need to develop in Enterprise Zones. Your testimony will be very helpful in evaluating proposals to establish Enterprise Zones.

Since the hearing, some Members of the Committee had additional questions, which have been enclosed with this letter. If you would be kind enough to respond to these questions in writing at your earliest convenience, it would be appreciated and helpful in completing the hearing record.

Again, thank you very much for your participation in what I believe was a very productive hearing.

With best wishes, I am,

Sincerely,

LOWELL WEICKER, Jr.
Chairman

Enclosure

Mail: P.O. Box 206, Baltimore, Md. 21203 / Address: 3501 Brehms Lane, Baltimore, Md. 21213 / Phone: (301) 485-2323

CAREY
MACHINERY & SUPPLY CO., INC.

April 13, 1982

The Honorable Lowell Weicker, Jr.
United States Senate
Committee on Small Business
Washington, D. C. 20510

Dear Senator Weicker:

I was indeed glad to have the opportunity to testify before the Senate Committee on Small Business on February 25 concerning Enterprise Zone Legislation. I apologize for not answering your follow-up letter more promptly, but since the matter is still pending before the Congress, I hope my responses will still be timely.

The following are the specific questions you raised and my answers:

QUESTION A - What are your biggest concerns with the enterprise zone proposals as they stand now? Are there sufficient incentives to attract lenders and entrepreneurs?

ANSWER - (a) Too many zones are going to be created. (b) No provision for inexpensive seed capital. (c) No help in reducing operating expeneses. Tax credits for people who pay little or no taxes are not incentives. (d) No requirement that support services be furnished, nor funding for such services. (e) Legislation is growing too complex for small business to understand. In summary, there are not enough incentives to attract lenders and entrepreneurs for the local businessman.

QUESTION B - How will the budget reductions at the federal and local levels impact the need for improved services in areas designated as enterprise zones?

ANSWER - Budget reductions at federal and local levels will force the cutback of the kinds of support services which small businesses will need to survive in enterprise zones. Therefore, the furnishing of these services, if not legislated and funded, should at least be clearly identified as one of the key factors in the competition by cities for zone designation.

QUESTION C - Will insurance costs and the crime rate in any potential zone have a significant bearing on the potential for success of any zone?

ANSWER - The impact of insurance costs and crime rates will vary from zone to zone. Obviously where it is worse, it's impact will be the greatest. Since we cannot generalize as to the priorities of needed assistance from zone to zone, consider a unique approach that I suggested in my testimony.

Carey Machinery & supply company, incorporated

> "The companies that come to the zones might be allowed to choose among a variety of benefits and services up to a certain total dollar value per year per employee, cafeteria style. This is analogous to the concepts currently coming into vogue in personal benefit programs where the individual chooses what is best for him within limits established by the company. The logic behind the development of this approach to benefits is the same as the logic I am suggesting for enterprise zone legislation. We really can't be sure which benefits and services would mean the most to a company considering an enterprize zone, so let it choose for itself."

I appreciate your continuing interest in my views. If I can be of further help, please don't hesitate to call or write.

Sincerely,

CAREY MACHINERY & SUPPLY CO., INC.

G. Cheston Carey, Jr.
President

GCC, Jr/jm

cc: Mr. Frank Gallagher
Greater Baltimore Committee

Mr. David Sloane
National Association of Wholesaler-Distributors